125 FERC ¶ 63,020
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Transcontinental Gas Pipe Line Corporation — Docket Nos. RP06-569-000, RP07-376-000 (consolidated)

INITIAL DECISION

(Issued November 21, 2008)

APPEARANCES

Michael J. Thompson, Matthew K. Segers, David A. Glenn, Julie Baumgarten, and Ira Megdal on behalf of Transcontinental Gas Pipe Line Corporation.

James H. Jeffries IV on behalf of the Piedmont Natural Gas Company, Inc. and the WSS Customer Group.

Jeffrey A. Gollomp on behalf of Fortis Energy Marketing & Trading GP.

Ira G. Megdal on behalf of South Jersey Resources Group.

Jon L. Brunenkant, Joelle K. Ogg, Kenneth Albert, Ron Oppenheimer and Kelly Funderburk on behalf of Merrill Lynch Commodities, Inc.

David D'Alessandro, Kelly A. Daly and John E. McCaffrey on behalf of the Public Service Commission of New York.

Shelby L. Provencher on behalf of the Public Service Company of North Carolina.

William J. Collins and Irene E. Szopo on behalf of the Commission Trial Staff.

STEVEN A. GLAZER, Presiding Administrative Law Judge

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I. INTRODUCTION

1. This case concerns whether it is just and reasonable for Transcontinental Gas Pipe Line Corporation's tariff for Washington Storage Service-Open Access (WSS-OA) to be changed to impose higher rates than other customers are charged upon the successors of customers who, upon terminating this service, exercised tariff-granted options to purchase base gas at low average historic prices, requiring Transco to replenish that base gas at far higher market prices. I conclude that it is not, and that the costs of those purchases should instead be rolled-in equally to the rates of all WSS-OA customers.

2. This case also concerns whether those option provisions in the tariff are themselves just and reasonable. I conclude that they have not been shown to be unjust and unreasonable in view of the first conclusion, but I find that they do not meet the present-day needs of any of the parties to this case and should be re-negotiated, with the Commission's guidance.

3. Further, this case concerns whether, if the option provisions are unjust and unreasonable, certain proposed alternatives to allowing other customers to exercise those option provisions are just and reasonable. As I do not find the existing option provisions to be unjust and unreasonable in view of the first conclusion, I do not reach this question.

II. THE PARTIES

4. Transcontinental Gas Pipe Line Corporation (Transco) is a natural gas pipeline company engaged in the transportation of natural gas in interstate commerce. Its natural gas transmission system extends from its principal sources of natural gas supply in the states of Texas, Louisiana, Mississippi and Alabama and the offshore Gulf of Mexico area, through the states of Georgia, South Carolina, North Carolina, Virginia, Maryland, Pennsylvania and New Jersey, to the New York City metropolitan area. Among its jurisdictional businesses is its operation of the Washington Storage Field, a natural gas storage facility in St. Landry Parish, Louisiana.

5. Intervenor WSS Customer Group (WSS Customer Group) is an ad hoc group of nine WSS customers that represents about 80 percent of the deliverability and capacity rights in the Washington Storage Service. The co-intervenors in WSS Customer Group are: Atlanta Gas Light and Pivotal Utility Holdings, Inc.; Brooklyn Union Gas Company and Keyspan Energy Delivery; Long Island Consolidated Edison Company of New York; PECO Energy; Philadelphia Gas Works; Piedmont Natural Gas Company; Public Service Company of North Carolina, Inc.; Washington Gas Light Company; and Patriots Energy Group.

6. South Jersey Resources Group (South Jersey) is a local natural gas distribution company and a customer of Transco. South Jersey serves all or part of the seven southernmost counties of the State of New Jersey, including Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester and Salem.

7. Fortis Energy Marketing and Trading GP (Fortis), also a customer of Transco, is involved in the organization of natural gas supply for wholesale customers. In 2006, Fortis acquired Cinergy Marketing & Trading, LP (Cinergy), which was then a customer of Transco. As a result, Fortis obtained Cinergy's WSS capacity rights.

8. The New York Public Service Commission (NYPSC) has also intervened in this matter and submitted a brief on certain issues.

III. PROCEDURAL HISTORY

9. This case arises from an issue that was reserved for litigation in an uncontested settlement agreement that I certified in this Docket to the Commission for approval on January 9, 2008. The Agreement culminates a complex series of tariff filings, hearings, decisions and settlements spanning approximately five years. The following chronology of those filings provides context for this proceeding.

10. On July 23, 2002, the Commission approved a Stipulation and Agreement in a rate case that Transco filed in Docket Nos. RP01-245-000, *et al*., (the RP01-245 Agreement).[1] The RP01-245 Agreement resolved, subject to reservations and adjustments, Transco's cost of service, overall throughput level and throughput mix for the rate period, cost classification, and cost allocation and rate design. The Agreement also reserved 14 issues for subsequent litigation.

11. In an Initial Decision issued on December 3, 2002 in Docket No. RP01-245-000, the late Administrative Law Judge David I. Harfeld reached determinations on 13 of the 14 reserved issues (the fourteenth issue was settled before trial).[2] In an Order issued on March 26, 2004, the Commission affirmed the Initial Decision in part and reversed it in part.[3]

12. In response to several requests for rehearing, the Commission issued an Order on

[1] *Transcontinental Gas Pipe Line Corp.*, 100 FERC ¶ 61,085 (2002).

[2] *Transcontinental Gas Pipe Line Corp.*, 101 FERC ¶ 63,022 (2002).

[3] *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299 (2004).

May 30, 2006 in Docket No. RP01-245-016 remanding one of the 13 issues, on allocation of certain storage costs, for hearing before Administrative Law Judge Edward Silverstein. The Commission also established a technical conference to resolve another reconsidered issue on the appropriate method of conducting pooling in Transco's Zone 4.[4]

13. On August 31, 2006, Transco made the first seminal rate filing of this case in Docket No. RP06-569-000, seeking a rate increase pursuant to Section 4 of the Natural Gas Act to reflect a $414 million increase in its annual revenue requirement. RP06-569-000 proposed changes in Transco's cost allocation and rate design in its tariff. As the remanded hearing and technical conference in RP01-245-016 were still pending, Transco held off incorporating cost allocations based on RP01-245-016 in making its filing in RP06-569-000 until "after a final Commission order no longer subject to rehearing" in the former case.

14. On September 29, 2006, the Commission accepted Transco's filing in RP06-569-000 and suspended the tariff sheets to be effective March 1, 2007, subject to refund. A hearing was established to address rate issues, including cost of service, cost allocation, rate design, rate of return, throughput, and depreciation rates.[5]

15. On October 3, 2006, the Commission issued an "Order Directing Compliance Filing" in Docket No. RP01-245-018 (October 3 Order).[6] The October 3 Order, among other things, required Transco to submit a compliance filing to implement the Commission's resolution of three issues that were already settled in the RP01-245 proceeding. Transco submitted its compliance filing on November 2, 2006, providing pro forma tariff sheets in response to the October 3 Order (November 2, 2006 Compliance Filing).

16. On October 3, 2006, Chief Administrative Law Judge Curtis L. Wagner appointed me as the Presiding Judge in the RP06-569-000 proceeding.

17. On November 27, 2006, the Commission approved Transco's Stipulation and Agreement in RP01-245-016 (RP01-245 Storage Agreement) that resolved two issues in that proceeding pertaining to the allocation of certain storage costs to transmission services and the unbundling of Emergency Eminence storage service. The Commission provided that the RP01-245 Storage Agreement would be effective on March 1, 2007.

18. On March 1, 2007, the Commission issued a letter order in Docket No. RP01-245-

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[4] *Transcontinental Gas Pipe Line Corp.*, 115 FERC ¶ 61,268 (2006).

[5] *Transcontinental Gas Pipe Line Corp.*, 116 FERC ¶ 61,314 (2006).

[6] *Transcontinental Gas Pipe Line Corp.*, 117 FERC ¶ 61,009 (2006).

020, accepting Transco's November 2 Compliance Filing and requiring Transco to file actual tariff sheets to be effective as of March 1, 2007.

19. On March 9, 2007, Transco filed in Docket No. RP01-245-022 revised tariff sheets (the March 9, 2007 Compliance Filing) consistent with the approved pro forma tariff sheets, updated to incorporate the impact of filings made subsequent to the November 2, 2006 Compliance Filing.

20. On March 30, 2007, Transco made the second seminal filing of this case in Docket No. RP07-376-000, requesting authorization to sell 7,858,990 dekatherms (Dth) of excess Eminence top gas using the posting and bidding procedures under its tariff. Transco also requested waiver of its tariff provisions requiring revenues from the sale to be passed through to customers as part of Transco's imbalance cash-out program.

21. On May 3, 2007, the Commission consolidated RP07-376-000 with RP06-569-000 and set for hearing the issue of whether Transco should retain any gain from the sale of the Eminence top gas.[7]

22. On June 7, 2007, the Commission issued an "Order Denying Rehearing and Accepting Compliance Filings" in Docket Nos. RP01-245-019, RP01-245-021, RP01-245-022 and RP06-569-001 (June 7, 2007 Order).[8] In the June 7, 2007 Order, the Commission accepted the tariff sheets in the Motion Rate Filing in Docket No. RP06-569-001, in the Docket No. RP01-245 Storage Agreement Filing, and in the March 9, 2007 Compliance Filing in Docket No. RP01-245-022. The Commission accepted the rates in all three filings subject to the outcome of the RP06-569-000 proceeding.[9]

23. From February 2007 to July 2007, the parties engaged in extensive settlement negotiations to resolve the issues presented in RP06-569-000 and RP07-376-000. They exchanged approximately 20 settlement offers before reaching a final agreement.

24. On November 28, 2007, the parties filed an uncontested Stipulation and Agreement of Settlement in RP06-569-000 and RP07-376-000 (Settlement Agreement). I certified the Settlement Agreement to the Commission for approval on January 9, 2008, noting that it resolved all of the issues set by the Commission for hearing in those dockets except for an issue identified in Section A of Article VII of the Settlement Agreement that was reserved for litigation. That remaining issue, which originated from an issue presented in RP06-569-000, regarded Transco's proposal under Section 4 of the Natural

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[7] *Transcontinental Gas Pipe Line Corp.*, 119 FERC ¶ 61,105 (2007).

[8] *Transcontinental Gas Pipe Line Corp.*, 119 FERC ¶ 61,255 (2007).

[9] *Id.* at P22.

Gas Act to establish incremental rates for its Washington Storage Service-Open Access gas storage service under Tariff Rate Schedule WSS-OA that would be applied to Fortis and South Jersey to recover Transco's cost of purchasing replenishment base gas. The Commission approved the Settlement Agreement to become effective as proposed on March 7, 2008.[10]

25. On January 14, 2008, Chief Judge Wagner issued an order recommending a Track III schedule for the reserved issue. On January 30, 2008, I convened a pre-hearing conference and issued an order establishing a procedural schedule in conformance with the Track III procedural timelines.

26. On April 25 and 29, 2008, Transco and the WSS Customer Group filed motions to strike the portions of Fortis and South Jersey's direct and answering testimony. On May 19, 2008, I denied the motions to strike.

27. On July 10, 2008, a one-day trial was held. Post-hearing initial briefs were subsequently filed by the parties on August 21, 2008, and reply briefs were filed on September 12, 2008.

IV. BACKGROUND

28. As Transco explained in its original tariff filing in RP06-569-000 on August 31, 2006, Rate Schedules WSS and WSS-Open Access of the Transco Tariff contain provisions that allow certain buyers of WSS and WSS-OA storage service in the Washington Storage Field to purchase specified quantities of base gas at historical cost when they terminate service from the Field. The purchase price is approximately 89 cents per Dth and is generally based on the cost of the original injected base gas.[11]

29. Also pursuant to Rate Schedules WSS and WSS-OA, Transco is obligated to maintain sufficient base gas quantities to support the total top gas capacity entitlements of its customers. Since gas prices today are significantly higher than the price of the original injected base gas, the higher cost of the newly injected base gas increases rate base for the Washington Storage service, which in turn increases the return and taxes included in the cost of service.[12]

[10] *Transcontinental Gas Pipe Line Corp.*, 122 FERC ¶ 61,213 (2008).

[11] *Transco Notice of Change in Rates*, RP06-569-000, Part 1 of 2, at 6 (August 31, 2006).

[12] *Id.*

30. In its August 31, 2006 tariff filing, Transco proposed to collect the increased cost of service "from buyer(s) on whose behalf the newly injected base gas is or will be purchased" in the form of incremental rates.[13] These buyers were deemed by Transco to be the new shippers who replaced terminating customers that exercised their options to buy base gas at historic rates. The new customers were Fortis (at that time Cinergy), which replaced former customer PSEG Energy Resources and Trade LLC (PSEG); Entergy-Koch Trading LP (Entergy-Koch), which replaced former customer Columbia Gas of Virginia; and South Jersey, which replaced South Jersey Gas Company (South Jersey Gas). Transco further proposed in its filing that in each instance where base gas is replenished, it would be permitted to make a limited filing under Section 4 of the Natural Gas Act (NGA)[14] to recover the higher costs associated with the purchase of base gas. This was to be accomplished by changing the wording of Section 8.3 of Rate Schedule WSS-Open Access and Section 9 of Rate Schedule WSS to allow Transco to make such limited Section 4 rate filings.[15]

31. This proposal in the August 31, 2006 filing was modified by the Settlement Agreement that the parties reached and filed on November 28, 2007. In remarks accompanying the Settlement Agreement, Transco explained that Section 8.3 of Rate Schedule WSS-OA was being modified to provide that Transco would be allowed to submit a limited NGA Section 4 rate filing to seek to recover *only from new buyers* any increase in the cost of service attributable to Transco's replenishment of base gas to serve them when they contract for capacity vacated, through termination or permanent capacity release, by a terminating buyer. Transco deleted from Section 8.3 its proposal to submit a limited NGA Section 4 rate filing to recover any increase *from any buyers* in the cost of service attributable to Transco's replenishment of base gas to serve such buyers. Consistent with that change, Transco also eliminated proposed Section 9(b) of Rate Schedule WSS that would have permitted a similar limited NGA Section 4 rate filing as to existing buyers of WSS service.[16]

32. In Article III of the Settlement Agreement, the parties resolved to treat Entergy-Koch as a non-incremental ratepayer under Rate Schedule WSS-OA.[17] As for Fortis and South Jersey, the parties in Article VII reserved their treatment for litigation or further

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[13] *Id*. and at Sheet No. 27A.

[14] 15 U.S.C. § 717c (2000).

[15] *Transco Notice of Change in Rates*, *supra*, and at Sheet Nos. 134 and 135G.

[16] *Transco Stipulation and Agreement*, at 30 and Sheet Nos. 27A, 134 and 135G (November 28, 2007).

[17] *Id*. at 23-24.

settlement as follows:

> The parties have agreed to reserve for resolution pursuant to hearing or further settlement the issue of Transco's proposal under NGA Section 4 to establish incremental rates under Rate Schedule WSS-Open Access applicable to Cinergy Marketing & Trading, LP (and its successor Fortis Energy Marketing and Trading) and South Jersey Resources Group, LLC to recover Transco's cost of purchasing replenishment base gas.[18]

33. On February 19, 2008, the participants in this proceeding filed a Stipulation of Issues.[19] The Stipulation provides that: (1) all parties will base their testimony and exhibits on the fixed cost component ($19,220,310) of the total Rate Schedules WSS/WSS-Open Access cost of service shown in Appendix B, Statement I, Exhibit No. T-1, page 30, of Transco's March 9, 2007 Compliance Filing; (2) Transco's re-stated direct testimony on the reserved issue will include an attached schedule reflecting its proposal, except that the incremental base gas purchases attributed to Entergy-Koch's successor, Merrill Lynch Commodities Inc. (Merrill Lynch)[20] and the associated billing determinants will be treated on a non-incremental basis; and (3) any compliance filing made by Transco to implement the outcome of the litigation of the reserved issue will be based on the WSS cost of service underlying the Settlement Agreement.

V. ISSUES AND DISCUSSION

A. Issue: *Whether Transco's proposal under NGA Section 4 to establish incremental rates under Rate Schedule WSS-OA applicable to Fortis and South Jersey to recover Transco's cost of purchasing replenishment base gas is just and reasonable and not unduly discriminatory or preferential.*

1. Positions of the Parties

a) Transco

34. Transco argues that its proposal to establish incremental rates for Fortis and South Jersey are just and reasonable and consistent with Commission policy and precedent. Transco adds that neither Staff nor Fortis and South Jersey have identified any flaw in Transco's proposal that renders it unjust and unreasonable.

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[18] *Id*. at 31.

[19] Exh. J-1.

[20] *See* Transco Reply Brief 7 n.4.

35. Transco underscores that the Supreme Court and the Commission have long recognized that ratemaking is "less a science than it is an art," and there can be more than one just and reasonable method for allocating costs and determining rates.[21] Transco asserts that it is not required to demonstrate that its proposal is more reasonable than alternative proposals, but to show that its proposal yields rates that are just and reasonable.[22] Transco explains that therefore, even if one or more of the alternatives proposed in this case may also be reasonable, that fact would not, as a matter of law, support rejection of Transco's proposal. Under the applicable legal standard, Transco says, the sole question is whether Transco's proposed rates are just and reasonable.

36. Transco explains that the Commission's policy preference for incremental pricing for new customers and services illustrates a desire to send efficient pricing signals to shippers and to protect existing customers from rate increases during the terms of their contracts that would subsidize new customers and services. The Commission's 1999 Pricing Policy Statement establishes that the Commission's goal in the pricing of investments in pipeline expansions is to achieve efficient pricing signals to new pipeline customers, while preventing existing shippers from being required to subsidize new facilities and services.[23] The Commission also explained in that Statement that long-term contracts provide buyers with greater price certainty:

> One of the benefits generally associated with long-term contracts is that they reduce the buyer's risk by providing greater price certainty. Raising the rates of existing shippers during the term of their long-term contracts in order to subsidize expansions for new shippers reduces rate certainty and increases contractual risk.[24]

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[21] *Cities of Bethany v. FERC*, 727 F.2d 1131, 1138 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 917 (1984); *Ala. Elec. Coop., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982); *Int'l Transmission Co.*, 123 FERC ¶ 61,065, at P 20 (2008).

[22] *Cities of Bethany*, 727 F.2d at 1136; *Louisville Gas and Elec. Co.*, 114 FERC ¶ 61,282, at P 29, *reh'g denied*, *E. ON U.S. LLC*, 116 FERC ¶ 61,020 (2006); *Cal. Indep. Sys. Operator Corp.*, 98 FERC ¶ 61,102 (2002).

[23] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 (1999), *clarified*, 90 FERC ¶ 61,128, *clarified*, 92 FERC ¶ 61,094 (2000) (1999 Pricing Policy Statement); *See also, Pricing Policy for New and Existing Facilities Constructed by Interstate Natural Gas Pipelines*, 71 FERC ¶ 61,241 (1995), *reh'g denied*, 75 FERC ¶ 61,105 (1996).

[24] 1999 Pricing Policy Statement, *supra*, 90 FERC ¶ 61,128 at 61,393.

37. Transco also points to recent signs of the Commission's preference for incremental pricing by applying the 1999 Pricing Policy Statement outside the context of pipeline expansions. Thus, the Commission has required incremental pricing to prevent subsidies of new services by existing customers for expansion facilities that were built before the Commission adopted its current policy,[25] for the cost of electric power associated with new electric compression installed as part of an expansion project even though that compression is operated on a fully integrated basis,[26] and for the cost of operating and maintaining expansion facilities that are operationally indistinguishable from non-expansion facilities.[27]

38. Transco further notes that the Commission has emphasized that both rolled-in rates and incremental rates can be just and reasonable for the same service, and that in such cases the pipeline may propose either pricing methodology and the Commission will accept the pipeline's proposal.[28]

39. Transco argues that while the present proceeding does not involve the construction of expansion facilities, it does involve an incremental investment by Transco in a plant asset, storage base gas, that was required in order to provide the storage service for which Fortis and South Jersey contracted.

40. Transco contends that the guidance provided by the Commission's 1999 Pricing Policy Statement and subsequent precedent indicate that the cost of the replenishment base gas in this case should be priced incrementally to the buyers on whose behalf the base gas was purchased. According to Transco, PSEG and South Jersey Gas exercised their rights under Rate Schedule WSS-OA to purchase 3,318,523 Dth of base gas in connection with the releases of their service to Fortis and South Jersey. Consequently, Transco had to replenish that same amount of base gas in order to provide service to remaining customers and new customers Fortis and South Jersey under Rate Schedules WSS and WSS-OA.[29] Transco bought the required quantities of replacement base gas in

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[25] *Transcontinental Gas Pipe Line Corp.*, 94 FERC ¶ 61,360, at 62,301-303, *reh'g denied*, 95 FERC ¶ 61,268, at 61,950-952 (2001).

[26] *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299, at PP 122-24 (2004), *order on reh'g*, 112 FERC ¶ 61,170, at PP 107-112 (2005), *order on reh'g*, 121 FERC ¶ 61,294 (2007).

[27] *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299, at PP 191-92.

[28] *Transcontinental Gas Pipe Line Corp.*, 87 FERC ¶ 61,087, at 61,387-88 (1999); "*Complex*" *Consol. Edison Co. of New York v. FERC*, 165 F.3d 992, 1003-04 (D.C. Cir. 1999); *Tennessee Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,224 (1997).

[29] Exh. T-4 (Hutson Test. 5:19-6:2).

April, October and November 2006.[30] Since the replacement base gas was purchased at prices higher than the historical cost of the originally injected base gas, the higher cost of the newly injected base gas increased the rate base for the WSS/WSS-OA service, which in turn raised the return and income taxes included in the cost of service.[31]

41. Transco says that resolution of the sole issue in this proceeding – whether the costs of the replacement base gas purchased by Transco to provide service to Fortis and South Jersey should be priced on a rolled-in or incremental basis – hinges on whether rolling-in such costs is consistent with the 1999 Commission Pricing Policy. That Policy, Transco maintains, establishes a three-prong test showing that a roll-in of costs is preferable to incremental pricing if: 1) the new facilities are needed to improve service to existing customers; 2) the increased rates are related to improvements in service; and 3) raising rates to existing customers will not constitute a subsidy to new incremental customers.

42. Transco contends that the rolled-in rate treatment does not satisfy the three-pronged test justifying a rolled-in rate. First, Transco contends, the base gas replacement did not improve the service received by the WSS/WSS-OA customers other than Fortis and South Jersey. Transco explains that while the newly injected base gas supports the delivery capability of the Washington Storage Field, it does not improve existing service received by the non-incremental WSS customers. In contrast, the service received by the non-incremental WSS customers after the base gas replacement is identical to the service they received prior to the sale of the base gas to PSEG and South Jersey Gas.[32] Moreover, the total quantity of base gas needed to provide the total combined service under Rate Schedules WSS/WSS-OA is unaffected by the permanent releases of PSEG's and South Jersey Gas's WSS-OA contracts to Fortis and South Jersey.[33]

43. Transco challenges Staff's statement that a portion of the replacement gas is needed to maintain the then-existing customers' level of top gas capacity entitlement, and thereby constitutes an "improvement" to the service to existing customers.[34] Transco asserts that Staff's position is based on a hypothetical scenario in which no replacement shippers subscribe to the capacity released by PSEG and South Jersey Gas. That scenario, Transco contends, is untenable for reasons discussed in detail later herein.

[30] Exh. T-2 at 1.

[31] Exh. T-1 (Hutson Test. 5:8-12).

[32] Exh. T-4 (Hutson Test. 9:22-10:2).

[33] *Id.* at 5:16-19.

[34] Exh. S-1 (Radel Test. 7:15-8:1).

44. Transco notes that, as the Washington Storage Field is an integrated operation, the total quantity of base gas and the total deliverability of the Field are inter-related.[35] However, Transco argues, the integrated operation of a pipeline's facilities is not determinative of cost responsibility. For example, Transco points out, the Commission accepted evidence in Transco's RP01-245 general rate case proceeding that electric compressors added to the system pursuant to an expansion project are integrated physically and operationally into Transco's system and, like all of Transco's other mainline facilities, are used to provide service to all customers, regardless of how their services are priced.[36] Nevertheless, the Commission held, the cost of the additional electric power used to operate the compressors must be charged incrementally to the expansion shippers.[37] Similarly, Transco says, it is appropriate here to assign to Fortis and South Jersey the incremental cost incurred by Transco to purchase the base gas necessary to provide their service.

45. Transco also challenges Staff's contention that, since all base gas benefits the deliverability of all top gas capacity entitlements, a portion of the replacement base gas should be allocated to the non-incremental WSS customers. According to Transco, the Commission stated that, to justify rolled-in treatment of incremental costs, existing shippers must realize a specific benefit, not merely generalized benefits resulting from integrated operation of all system facilities.[38] Transco avers that Staff introduces no evidence that the replacement base gas at issue provides anything more than a general benefit of supporting the deliverability of all top base gas capacity entitlements. Therefore, Transco claims, rolled-in treatment for the replacement base gas would be inconsistent with the Commission's incremental pricing policy and precedents.

46. With regard to the second prong of the 1999 Pricing Policy Statement test, Transco asserts that rolling in the costs of the replacement base gas is inappropriate because the service that the non-incremental WSS customers receive after the base gas replacement is identical to the service they received before the sale of base gas to PSEG and South Jersey Gas. Transco explains that the increased rates charged to non-incremental WSS customers that would result from rolling in the costs of the replacement

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[35] Exh. T-4 (Hutson Test. 6:2-5).

[36] *Transcontinental Gas Pipe Line Corp.*, *supra*, 106 FERC ¶ 61,299, at P 115.

[37] *Id.* at PP 123-24. Commission subsequently reversed its holding regarding the SouthCoast electric compression because further evidence showed no increase in system electric power costs due to the addition of that facility. *See Transcontinental Gas Pipe Line Corp.*, 112 FERC ¶ 61,170, at PP 105-06 (2005).

[38] *Transcontinental Gas Pipe Line Corp.*, *supra*, 106 FERC ¶ 61,299, at P 75; *Transcontinental Gas Pipe Line Corp.*, *supra*, 112 FERC ¶ 61,170, at P 91.

base gas purchased to provide service to Fortis and South Jersey would not relate to any improvement in service for the existing customers.

47. Transco then addresses the third prong of the 1999 Pricing Policy Statement test, asserting that rolling in the costs of the replacement base gas that Transco purchased to provide service to Fortis and South Jersey would result in the non-incremental WSS customers subsidizing Fortis and South Jersey. Transco points out that according to Fortis and South Jersey, the overall benefit to the non-incremental WSS customers is "$142 million less $2.5 million plus $1 million."[39] Transco says that the $1 million in that equation is the annual amount of non-base gas related fixed costs contributed by Fortis and South Jersey's Rate Schedule WSS-OA service.[40] However, Transco argues, Fortis and South Jersey would contribute $1 million regardless of whether the replacement base gas costs are rolled-in or priced incrementally.[41] Moreover, Transco points out, Fortis and South Jersey concede that their roll-in proposal results in a shift of costs from Fortis and South Jersey to the non-incremental WSS customers equal to the cited $2.5 million,[42] creating a rate increase to the non-incremental WSS customers and a subsidy to the replacement customers. The result, Transco maintains, is contrary to the Commission's goal to protect captive customers from rate increases due to costs incurred to serve new customers.

48. Transco also claims that Fortis and South Jersey's suggestion that their proposal creates a $142 million benefit for the non-incremental WSS customers is specious. The base gas purchase option that Fortis and South Jersey tout as an economic benefit of their position is not created by their proposal, Transco says, but is a right that customers have today under Sections 9 and 8.2 of Rate Schedules WSS and WSS-OA, respectively.[43] Moreover, Fortis and South Jersey's witness conceded that their roll-in proposal not only does not create $142 million of value for the non-incremental WSS customers, but would dilute the value attributed to the base gas purchase right from $157 million to $142 million.[44] Therefore, Transco concludes, Fortis and South Jersey's calculations demonstrate that their roll-in proposal economically harms the non-incremental WSS customers by approximately $17.5 million.[45] Transco states that it is thus impossible for

[39] Exh. FS-1 (Jones Test. 33:7).

[40] *See id.* at 32:11-14.

[41] Exh. T-4 (Hutson Test. 11:4-6).

[42] Exh. FS-1 (Jones Test. 33:6).

[43] Exh. T-5.

[44] Exh. FS-1 (Jones Test. 32:22-33:3, 35:7); Jones Tr. 204:3-8.

[45] Exh. T-4 (Hutson Test. 12:7-10).

Fortis and South Jersey to attribute economic benefits to their proposal when, in actuality, their approach would result in a subsidy to Fortis and South Jersey, at the expense of the non-incremental WSS customers.

49. Transco disputes Fortis and South Jersey's claim that Transco's proposed rates are discriminatory because the replacement customers are similarly situated to the non-incremental WSS customers.[46] Transco asserts that Fortis and South Jersey are not similarly situated to the non-incremental WSS customers because, unlike the non-incremental WSS customers, Fortis and South Jersey are replacement shippers for whom Transco had to buy replacement base gas in order to provide their service.[47] Transco argues that a difference in treatment between customers is not unduly discriminatory if the customers are not similarly situated, and thus there is a rational basis for the difference.[48] Transco says the dissimilarity therefore destroys Fortis and South Jersey's claim of undue discrimination. Furthermore, Transco says, the costs or investment incurred by a pipeline to provide service to new customers justifies assessing an incremental rate to those customers.[49] Additionally, Transco claims that the fact that it successfully implemented 10 different incremental rates under its Rate Schedule FT rebuts Fortis and South Jersey's claims that Transco's proposal would be administratively burdensome.[50]

50. Transco also responds to Fortis and South Jersey's comment that Transco has previously developed single, average rates to recover the cost of additional base gas purchased for expansions of the Washington Storage Field. According to Fortis and South Jersey, Transco's previous practice renders any attempt to impose incremental rates in this case unduly discriminatory. Transco retorts that the last expansion of the Washington Storage Field for which Transco proposed to roll-in the costs of purchased base gas was in 1981.[51] When those purchases of base gas were made, Transco points

[46] Exh. FS-1 (Jones Test. 4:4-5, 14:4-15:10, 34:16-17); Exh. T-7.

[47] Exh. T-4 (Hutson Test. 12:21-13:2).

[48] *See, Tenn. Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,245 (1997); *see also, Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305, 1316 (D.C. Cir. 1991)*; see also, Tenn. Gas Pipeline Co. v. FERC*, 860 F.2d 446, 452 n.9 (D.C. Cir. 1988); *see also, Associated Gas Distrib. v. FERC*, 824 F.2d 981, 1009 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

[49] *See* Transco Initial Brief 6-8.

[50] *See id.* at 13.

[51] Exh. T-4 (Hutson Test. 8:5-22).

out, the Commission favored rolled-in pricing of pipeline expansion costs.[52] However, the Commission changed its policy in the 1999 Pricing Policy Statement,[53] which established the Commission's primary policy goal in the pricing of investments in pipeline expansions as the achievement of efficient pricing signals for new pipeline investment, while protecting existing shippers from being required to subsidize new facilities and services.[54] Therefore, Transco alleges, how it recovered the costs of purchasing base gas prior to the 1999 Pricing Policy Statement is irrelevant.

51. Additionally, Transco rejects Fortis and South Jersey's suggestion that Transco's proposed treatment of the cost of base gas purchased to replace gas sold to Columbia Gas of Virginia undermines Transco's proposed incremental rates for Fortis and South Jersey. Transco initially proposed in this proceeding to allocate the relevant costs incrementally to Columbia Gas of Virginia's replacement shipper, Merrill Lynch.[55] That the parties to this proceeding – including Fortis and South Jersey – agreed in the Agreement to roll-in the cost of the base gas purchased to provide service to Merrill Lynch is neither inconsistent with Transco's proposed rates for Fortis and South Jersey, nor relevant, Transco replies. As with all settlements, the Commission's approval of the Agreement "does not constitute approval of, or precedent regarding, any principle or issue in this proceeding."[56]

52. Transco refutes Fortis and South Jersey's arguments that a) Transco must establish a change in circumstances in order to meet its NGA Section 4 burden to justify changing the company's rate structure;[57] b) Transco's proposed rate structure violates FERC policy regarding cost-based storage rates;[58] (c) Transco's proposed rates are inconsistent with the Commission's storage and rate policies;[59] and (d) the incremental rates as proposed by Transco were anti-competitive and therefore inconsistent with the Commission's pro-competitive, market-based storage rate policies.[60] Transco says that Fortis and South

[52] Transco Initial Brief 7 n.7.

[53] 1999 Pricing Policy Statement, *supra.*

[54] *See id.*

[55] *See*, Initial Transco Rate Proposal at Exh. T-1, Statement I, Page 31 and Schedule J-2, Page 25, Docket No. RP06-569-000 (Aug. 31, 2006); *see also*, Agreement at Article III, Section C, Docket No. RP06-569-000 (Nov. 28, 2007).

[56] *Transcontinental Gas Pipe Line Corp.*, 122 FERC ¶ 61,213, at P 11 (2008).

[57] Exh. FS-1 (Jones Test. 34:17-20).

[58] *Id.* at 4:6-7.

[59] *Id.* at 15:9-10.

[60] *Id.* at 35:4-6.

Jersey do not provide support for these positions with Commission policy.

53. Transco avers that Fortis and South Jersey's characterization of Transco's incremental rate proposal as an unlawful "bait-and-switch" is baseless.[61] Transco asserts that the incremental proposal is consistent with the rate provisions of the service agreements with Fortis and South Jersey. As for Fortis and South Jersey's contention that they only agreed to pay Transco's maximum WSS-OA rate at the time they entered into their service agreements as replacement shippers for, respectively, PSEG and South Jersey Gas, and thus did not agree to pay the incremental rates Transco is proposing for their service in this proceeding,[62] Transco claims that the following language in Article IV of the service agreement language refutes Fortis and South Jersey's argument:

> [Fortis and South Jersey] shall pay Seller for natural gas service rendered hereunder in accordance with Seller's Rate Schedule WSS-Open Access, and the applicable provisions of the General Terms and Conditions of Seller's FERC Gas Tariff as filed with the Federal Energy Regulatory Commission, and as the same may be amended or superseded from time to time.[63]

According to Transco, this provision, known as a "*Memphis*" clause, is contained in several of Transco's other service agreements, and authorizes Transco to propose unilateral rate changes pursuant to NGA Section 4.[64]

54. Additionally, Transco claims that it communicated to both PSEG and South Jersey Gas that Transco might propose in this proceeding that the replacement service be priced incrementally or at higher rates.[65] Transco contends that a Transco representative discussed with an employee of Cinergy (Fortis' predecessor) the potential that higher rates and perhaps incremental rates could apply to the WSS-OA service that Cinergy then was in the process of acquiring from PSEG.[66]

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[61] Exh. FS-1 (Jones Test. 20:21-21:2).

[62] Fortis and South Jersey Initial Brief 2-3.

[63] Exh. T-8 and T-9, Article IV.

[64] Transco Initial Brief 19; *see Transcontinental Gas Pipe Line Corp.,* 85 FERC ¶ 61,357, at 62,392-93 (1998), *on reh'g*, 86 FERC ¶ 61,175, *reh'g denied*, 88 FERC ¶ 61,135 (1999); *see also Exxon Corp. v. FERC*, 206 F.3d 47, 52 (D.C. Cir. 2000), *on remand sub nom. Transcontinental Gas Pipe Line Corp.*, 95 FERC ¶ 61,322, at 62,131, 62,139 n.54 (2001).

[65] Exh. T-4 (Hutson Test. 17:22-18:3); Exhs. T-10 and T-11.

[66] Exh. T-4 (Hutson Test. 18:5-9).

55. Transco further states that Fortis and South Jersey offer no evidence that Transco has any obligation to identify potential replacement WSS-OA shippers and notify them of a potential rate change before proposing such a change in a Section 4 filing. Therefore, whether Transco discussed with Fortis and South Jersey the possibility that their acquired storage service could be subject to incremental rates is simply immaterial to the Commission's determination of the lawfulness of Transco's proposed incremental rates.

56. Transco also argues that Staff's proposed alternative to its incremental rate proposal is unsupported by the facts in this proceeding, is inconsistent with Commission policy, and would result in an arbitrary and capricious cost allocation. The Staff's alternative is based on a Transco response to a Staff discovery request to the effect that, in the absence of any new storage customers to replace PSEG and South Jersey Gas, Transco would have needed to purchase 1,320,000 Mcf of base gas to support and maintain the storage service and top gas capacity entitlements of its remaining non-incremental WSS and WSS-OA customers.[67] Transco asserts that Staff has misconstrued this information.

57. First, Transco alleges, Staff has overlooked Transco's statement in its discovery response that, in the hypothetical situation presented by Staff's question, Transco would consult with its storage customers to determine whether they desired to maintain their existing service levels or would agree to reduce their service entitlements to the level supported by the remaining base gas.[68] Transco also contends that Staff likewise has disregarded Transco's statement that the relationship between the amount of base gas and the deliverability capability of the Washington Storage Field is not linear and that Transco, therefore, would need to know the aggregate WSS and WSS-OA contractual obligations existing at the time of the exiting customer's base gas purchase to determine the quantity of base gas (if any) that would have to be replenished.[69] This means, according to Transco, that depending upon the number of customers willing to accept less deliverability while maintaining their existing storage capacity entitlements, Transco may or may not have needed to replace the base gas purchased by the departing customers in Staff's hypothetical and, even if some replacement were necessary, it could well have been less than the 1,320,000 Mcf on which Staff bases its "hybrid" pricing proposal.[70] As the required investment in replacement base gas would differ depending on the remaining customers' choices, Transco says, it is unreasonable for Staff to assign

[67] Staff Initial Brief 5, 7-9, 11-12, 14.

[68] Exh. S-2 at 1.

[69] *Id.*

[70] Transco Initial Brief 11-12.

responsibility for the costs of the replacement base gas on the basis of a purely hypothetical set of circumstances.

58. Transco discounts Staff's counterargument that no Rate Schedule WSS and WSS-OA customer has lowered its top gas capacity entitlement.[71] Transco points out that it never had to ask them if they would like to reduce their entitlements since Fortis and South Jersey replaced PSEG and South Jersey Gas. Moreover, Transco avers, Staff cannot demonstrate that, in the event there had been no replacement shippers, and any or all of Transco's customers elected to lower their top gas capacity entitlements, Transco would in fact have had to purchase 1,320,000 Mcf (or any other quantity) to replace the base gas purchased by PSEG and South Jersey Gas. According to Transco, Staff's hypothetical circumstances are no substitute for the fact that Fortis and South Jersey's requests for service required Transco to actually purchase 3,318,523 Mcf of replacement base gas.

59. Transco also discounts Staff's characterization of Transco witness Charlotte Hutson's testimony on cross-examination that even if there had been no replacement shippers for PSEG and South Jersey Gas, and one or some, but not all, of the remaining customers agreed to reduce their top gas entitlements, the customers who reduced would pay higher rates to recover the cost of any additional base gas purchased to meet the top gas capacity entitlements of those who did not reduce.[72] Transco believes Staff miscomprehended Hutson's responses to Staff counsel's hypothetical questions,[73] and emphasizes that what may or may not be appropriate in other, hypothetical circumstances cannot determine the outcome for this proceeding.

60. Transco disagrees with Staff's support for its partial roll-in proposal as being necessary to "maintain and support" the top gas capacity entitlements of the non-incremental WSS/WSS-OA customers.[74] Transco does not dispute that the replacement base gas, like all Washington base gas, supports all customers' service. However, Transco says, that does not warrant rolling in a portion of the costs of such replacement base gas under the 1999 Pricing Policy Statement. According to Transco, rolled-in treatment for any portion of the cost of the replacement base gas would be inconsistent with the Commission's incremental pricing policy, and Staff's notion that the non-incremental customers' WSS/WSS-OA service was improved is illusory because physically and contractually nothing changed except the names of the buyers for whom

[71] *Id.*

[72] Staff Brief 14.

[73] *See* Hutson Tr. 159-62.

[74] Staff Initial Brief 4-9.

Transco provided WSS-OA service (PSEG to Fortis and South Jersey Gas to South Jersey).

61. Transco also argues that Staff's alternative to an engineering study would result in an arbitrary and capricious cost allocation. When Staff witness Janice L. Radel first put forth Staff's proposal to roll-in a portion of the cost of the replacement base gas, she stated that an engineering study was necessary in order to determine the amount of deliverability obtained for each customer group by the 1,320,000 Mcf cited in Exhibit S-2.[75] Transco claims that such a study is not possible because of the non-linear relationship between the field's deliverability and base gas inventory, and because the Field's constantly changing inventory makes it impossible to quantify the effect of the replacement base gas on the Field's deliverability in isolation from the effect of the other base gas.[76]

62. Transco disputes Staff's characterization of Transco witness Hutson's testimony as agreeing, in the absence of an engineering study, to spread the costs related to the 1,320,000 Mcf over all WSS-OA customer billing determinants.[77] Transco contends that while Hutson agreed that, if required, Transco could allocate the costs of the 1,320,000 Mcf of base gas over all customer billing determinants,[78] its feasibility is not enough to make this new proposal on the part of Staff just and reasonable. Specifically, Transco contends that Staff has failed to demonstrate how such an allocation would ensure that the cost of the replacement base gas would be allocated to the entities responsible for Transco's incurrence of the cost, as is required by the 1999 Pricing Policy Statement as well as the Commission's general ratemaking policies.[79] Transco contends that Staff's proposal would arbitrarily assign costs to Transco's existing customers without any regard for whether their service actually requires Transco to incur the cost of the replacement base gas. Transco argues that such a proposal is wholly inconsistent with the Commission's policies, and should be dismissed outright.

b) Fortis and South Jersey

63. Fortis and South Jersey argue that charging them incremental rates would be unjustified and unlawful. They explained that they were replacement WSS-OA

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[75] Exh. S-1 (Radel Test. 11:6-7).

[76] *See* Transco Initial Brief 12-13.

[77] Staff Initial Brief 11-12, 20.

[78] *See* Hutson Tr. 169-170.

[79] *See Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077, at P 290 (2006).

customers who acquired their capacity through permanent capacity release transactions from PSEG and South Jersey Gas, respectively. In so doing, both Fortis and South Jersey agreed to pay Transco's then-effective maximum WSS-OA rate, and both executed service agreements ratifying that obligation. Fortis' predecessor, Cinergy Marketing & Trading, LP, became a WSS-OA customer on March 31, 2005; South Jersey became a WSS-OA customer on May 1, 2006.

64. Fortis and South Jersey explain that Transco filed its August 31, 2006 tariff filing after they executed their replacement contracts, and in that filing Transco sought to replace the generally-applicable WSS-OA rate that Fortis and South Jersey agreed to pay with far-higher incremental rates.[80] These incremental rates, as further modified in the November 28, 2007 Settlement Agreement, are nearly three times the WSS-OA firm rates paid by other WSS-OA customers.[81] Fortis and South Jersey contend that Transco has not borne its burden under Section 4 of the NGA of proving that its proposal to charge Fortis and South Jersey incremental rates is just and reasonable.

65. Fortis and South Jersey assert that Transco's incremental rate proposal is unprecedented and contrary to rational ratemaking principles. They provide that in its rate filing, Transco largely continues its historical practice of treating its WSS-OA storage costs on a rolled-in basis. Transco includes on a rolled-in basis all of the fixed, non-base gas cost-of-service elements in its WSS-OA rates, and designs rolled-in injection and withdrawal rates to recover its variable storage costs. Here, however, Transco has proposed to roll-in and share among all WSS-OA customers all of the costs of providing WSS-OA storage service, with the exception of the return and taxes cost component, which it has priced on an incremental basis for the purpose of calculating rates for Fortis and South Jersey. Fortis and South Jersey are therefore being asked to pay a hybrid rate, where they bear their proportionate share of all WSS-OA storage costs, except for return and taxes on base gas, which they alone pay on a fully incremental basis.[82]

66. Fortis and South Jersey contend that Transco did not cite a Commission case or policy that supports the sort of base gas segregation and incremental costing treatment for replacement storage customers that it has proposed in this proceeding, and that none exists.[83]

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[80] *Transco Notice of Change in Rates*, *supra*, Sheet No. 27A.

[81] *Transco Stipulation and Agreement*, *supra*, Sheet No. 27A.

[82] Exh. FS-1 (Jones Test. 5:3-19).

[83] *Id.* at 6:12-13.

67. Fortis and South Jersey add that Transco does not practice this incremental costing treatment for any of its other storage services.[84] Furthermore, Fortis and South Jersey argue that the customary treatment for base gas is to value that gas on an average, rolled-in basis and design rates accordingly, rather than artificially segregate base gas purchases by cost vintage.[85] Fortis and South Jersey assert that it is not possible for Transco to segregate a specific quantity of base gas and then use it for the exclusive benefit of any particular WSS-OA customer, because all base gas supports all WSS-OA customers.[86] Fortis and South Jersey explain that more than 40 percent of the replacement gas was necessary to support the deliverability of the remaining WSS-OA customers' capacity entitlements.[87] Fortis and South Jersey emphasize that Transco recognizes the operational realities of its WSS-OA storage service by its practice of recovering every other storage cost component equally from all WSS-OA customers on a rolled-in basis.

68. Fortis and South Jersey also argue that Transco's incremental rate proposal unduly and unlawfully discriminates against them. Section 4(b) of the NGA prohibits natural gas companies from:

> "(i) mak[ing] or grant[ing] any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain[ing] any unreasonable difference in rates, charges, service, facilities, or in any other respect … [88]

They argue that the Commission will determine that Section 4(b) has been violated if it finds that a regulated utility is imposing materially different rates for similarly situated customers.[89]

69. Fortis and South Jersey argue that Transco is imposing different rates for shippers who receive identical service. They challenge the testimony of Transco witness Hutson

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[84] *Id.* at 18:9-18.

[85] *Id.* at 6:12-13.

[86] Exh. FS-1 (Jones Test. 23:9 – 25:18); Exh. FS-7.

[87] Exh. FS-1 (Jones Test. 32:6 – 33:8); Exhs. FS-11, FS-4, and FS-5.

[88] 15 U.S.C. § 717c(b).

[89] *See, e.g.*, Order No. 697-A, *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, 123 FERC ¶ 61,055 at P 453 (2008) *citing*, *Southwestern Electric Cooperative, Inc. v. FERC*, 347 F.3d 975, 981 (D.C. Cir. 2003) (stating that "the standard for judging undue discrimination remains what it always has been: disparate rates or service for similarly situated customers").

to the effect that the sole difference between Fortis and South Jersey and the other WSS-OA customers that justified Transco's disparate rate treatment was that Fortis and South Jersey were replacement customers for whom Transco purchased base gas volumes to replace those volumes withdrawn by the releasing customers, PSEG and South Jersey Gas.[90]

70. Fortis and South Jersey provide that the alleged differences between them and the other WSS-OA customers are not sufficient to justify a discriminatory rate treatment. First, Fortis and South Jersey explain that they are identically situated to their predecessors and to all other WSS-OA customers, as they are bound by Transco's standard WSS-OA Form of Service contract and are subject to the same WSS-OA Rate Schedule and General Terms and Conditions applicable to all of the WSS-OA customers who pay rolled-in rates.

71. Second, Fortis and South Jersey refute Transco's claim that its purchase of replacement base gas justifies the discriminatory rate treatment. Fortis and South Jersey provide that Transco has a long record of filing for rolled-in rates to recover the costs of additional base gas purchases even when that gas was purchased for the direct benefit of specific WSS-OA customers,[91] and even in instances where the resulting increase to the existing rolled-in storage rates was greater than the increase that would result from rolling-in the costs of the PSEG and South Jersey Gas replacement purchases in this proceeding.[92] Transco has always maintained a single average cost of base gas for its WSS service, and a single storage rate, although the average cost of its base gas has increased significantly with WSS capacity additions.[93] Additionally, Fortis and South Jersey note that the historic increase in Transco's average base gas costs from September of 1978 through July of 2003 was 67 percent, which would have been identical to the rate increase that would result from the roll-in of the PSEG and South Jersey Gas replacement purchases.

72. Fortis and South Jersey also argue that the 1999 Pricing Policy Statement has at best tenuous relevance to the circumstances underlying this proceeding, and therefore fails as a justification for Transco's incremental rate proposal. The Pricing Policy Statement is directed at the construction of new pipeline transportation and storage facilities, and does not address issues associated with capacity release transactions. Fortis

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[90] Hutson Tr. 141:24-142:3.

[91] Exh. FS-1 (Jones Test. 9:16-10:18).

[92] *Id*. at 11:13-12:8; Exh. FS-4 (showing base gas cost impacts of various base gas purchases).

[93] Exh. FS-1 (Jones Test. 9:16-10:18); Exh. FS-2.

and South Jersey state that the Commission has never applied the 1999 Pricing Policy Statement to directly assign the costs of base gas purchases to permanent replacement storage customers.

73. Fortis and South Jersey explain that, in the Pricing Policy Statement, the Commission was concerned with articulating a policy that would ensure that physical expansions of natural gas transportation and storage infrastructure were undertaken in an economically efficient manner, by fully accounting for the monetary and environmental costs of new construction, including any external costs in the form of rate subsidies from existing customers, and by providing the principal stakeholders (*i.e.* the utility and the prospective expansion customer) with a high degree of economic certainty prior to the construction of the new facilities.

74. Fortis and South Jersey contend that these policy goals do not translate to the issues associated with permanent capacity releases. In the context of capacity release transactions, the Commission is primarily concerned with ensuring that existing service entitlements are transferred among potential suppliers on a transparent and uniform basis. In this way, Fortis and South Jersey provide, the Commission fosters more robust interstate gas markets by allocating unused capacity to those in the best position to employ it.

75. Fortis and South Jersey argue that Transco's incremental proposal is inimical to these goals. Instead of acquiring service entitlements on the same basis as provided to the releasing customers by applying rolled-in rates, Fortis and South Jersey are asked to pay nearly triple the rate they originally agreed to pay to acquire this capacity, under a new rate classification that did not exist at the time they acquired their capacity. Fortis and South Jersey claim that they are therefore at a permanent structural cost disadvantage which they never agreed to assume.

76. Additionally, Fortis and South Jersey do not agree with Staff that their rolled-in rates should be replaced with the partially rolled-in rate structure. Fortis and South Jersey reject Staff's contention that revoking their rolled-in rate treatment comports with the 1999 Pricing Policy Statement's goal of establishing proper price signals.[94] Fortis and South Jersey explain that they are replacement customers, not "new incremental customers,"[95] and when they assumed the capacity of their respective releasing customers, they agreed to pay the fully rolled-in, then-effective tariff rate paid by their predecessors. Fortis and South Jersey contend that that was the "price signal" to which they responded.

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[94] Staff Initial Brief 10.

[95] Staff Initial Brief 10 n.26.

77. Fortis and South Jersey also note that rolled-in rates for Fortis and South Jersey would reduce their storage expenses, enabling them to reduce the prices of supply to their gas customers and strengthening their ability to compete for gas markets on an even footing with the other WSS-OA customers. Fortis and South Jersey state that rolled-in rates would also make them more likely to be in a position to compete for additional storage capacity. In other words, Fortis and South Jersey claim, rolled-in rates would increase the demand for released WSS-OA capacity when and if such capacity becomes available (benefiting the members of the WSS Customer Group) and for storage capacity from other providers (benefiting those providers and promoting additional market based storage).

78. Fortis and South Jersey add that if Staff believes that Transco's rolled-in rate treatment of Fortis and South Jersey is not just and reasonable because base gas costs must be directly assigned to each individual WSS-OA customer, then Transco must design a unique, individual rate for each WSS-OA customer that is based on the actual base gas purchase costs associated with each customer.

79. Fortis and South Jersey reject the WSS Customer Group's claim that the total roll-in proposal is unjust and unreasonable.[96] Fortis and South Jersey emphasize that fully rolled-in rates are the *status quo*. Prior to this rate case, Fortis and South Jersey paid the same fully rolled-in rate as the members of the WSS Customer Group. Fortis and South Jersey add that Transco proposes to depart from a fully rolled-in rate structure in favor of a partially rolled-in rate structure and that Transco therefore bears the burden of proof to justify this change.

80. Additionally, Fortis and South Jersey contend that the allegations that they were or should have been aware of incremental rates are baseless. Fortis and South Jersey note that there is no direct testimony on these matters from any person involved in the negotiation and execution of the permanent releases. In contrast, Fortis and South Jersey provide that the following facts are undisputed: 1) at the time they became storage customers, they became legally bound to pay Transco's then-existing rolled-in WSS-OA rate, pursuant to Transco's generally-applicable Form of Service Agreement for Rate Schedule WSS-OA; 2) Transco proposed the incremental rate applicable to Fortis and South Jersey after those parties became storage customers; 3) neither Fortis nor South Jersey have ever executed a previous agreement or any other contractual agreement in which it agreed to pay the new incremental rates proposed by Transco in this rate case; and 4) neither Fortis nor South Jersey have contracted away their rights under the NGA to challenge Transco's incremental rate proposal.

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[96] WSS Customer Group Initial Brief 14- 17.

c) WSS Customer Group

81. The WSS Customer Group argues that Transco's proposal to charge Fortis and South Jersey incremental rates is consistent with Commission policies on incremental capacity additions, avoids inappropriate subsidization of WSS service for new/replacement shippers at the expense of existing shippers, maintains appropriate price signals for WSS service, and is otherwise just and reasonable.

82. The WSS Customer Group notes that, generally, incremental rates are used to recover the costs of new facilities within existing rate structures. The WSS Customer Group asserts that Transco's context is analogous because it incurred significant capital expenditures solely for the purpose of providing service to new customers, at no benefit for existing customers.

83. The WSS Customer Group argues that the 1999 Pricing Policy Statement's three prong test does not support rolled-in rate treatment for the costs of providing service to Fortis and South Jersey. First, the WSS Customer Group state, Transco's purchase of replacement base gas did not improve WSS services.[97] The delivery and capacity rights of historic WSS shippers were identical before and after the base gas purchases. The base gas replenishment purchases were made to support the capacity entitlements of Fortis and South Jersey and to maintain the historic allocation of base gas responsibility under Transco's WSS tariffs. Therefore, the WSS Customer Group concludes, neither of the first two prongs of the Commission's test for rolled-in rate treatment is satisfied.

84. The WSS Customer Group then addresses the third prong of the 1999 Pricing Policy Statement. The WSS Customer Group explains that the roll-in of replacement base gas costs would require historic WSS shippers, who hold approximately 89 percent of WSS capacity rights, to pay for the majority of base gas costs needed to support service to Fortis and South Jersey. Consequently, the WSS shippers would be subsidizing Fortis and South Jersey.[98] Furthermore, the WSS Customer Group notes, the replacement base gas was purchased at rates of about \$6.00 per dekatherm, compared to the historic embedded cost of the base gas in the Washington Storage field of roughly \$0.89 per dekatherm.

85. The WSS Customer Groups adds that Staff's recommendation for a partial roll-in of replenishment bas gas costs would result in a disproportionate allocation of base gas responsibility between historic and incremental shippers. Historic shippers would be charged a disproportionately greater responsibility for base gas and Fortis and South

[97] Exh. T-4 (Hutson Test. 9-10).

[98] *Id*. at10-11.

Jersey would be charged a disproportionately smaller responsibility. This reallocation of base gas responsibility would not be accompanied by any change in service or deliverability rights, which will remain proportional between the historic shippers and the replacement shippers Fortis and South Jersey. Alternatively, under Transco's proposal, Fortis and South Jersey will be charged for the base gas replenishment costs purchased to support them. The WSS Customer Group argues that this system maintains the historic and proportional allocation of responsibility for base gas in the Washington storage Field.

86. The WSS Customer Group asserts that directing rolled-in treatment for incremental base gas purchases in the Washington Storage field, which is located in the same geographic region as many of the newly certificated or pending market-based rate storage facilities, sends an improper price signal to both potential incremental WSS shippers, as well as the market for production area storage capacity in general. The WSS Customer Group provides that a roll-in of incremental base gas costs associated with Fortis and South Jersey capacity would artificially reduce the costs to Fortis and South Jersey of obtaining production area incremental storage capacity below the comparable costs that must be paid by other production area storage customers at the expense of historic WSS shippers. The WSS Customer Group contends that this is contrary to the Commission's policy on market-based rates for incremental storage facilities[99] as well as the rationale underlying Section 312 of the Energy Policy Act of 2005 that it is in the public interest to promote the construction of additional natural gas storage facilities and that market-based rates promote such construction.

87. The WSS Customer Group notes that the allocation of base gas responsibility to WSS shippers was established many years ago based on the proportion of certificated top gas capacity to the base gas needed to support that capacity,[100] and that this methodology has not changed since the expansion of the Washington storage field in 1980.[101] The WSS Customer Group states that while this methodology may lack scientific precision, it is reasonable because the non-linear nature of deliverability in the Washington Storage Field and the other factors that vary based on WSS capacity rights over time and system operations are not primary factors in designing rates.[102]

88. The WSS Customer Group emphasizes that, besides Fortis and South Jersey, no

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[99] *Rate Regulation of Certain Natural Gas Storage Facilities*, 115 FERC ¶ 61,343 (2006) (Order No. 678); *Order on Clarification and Rehearing*, 117 FERC ¶ 61,190 (2006) (Order No. 678-A).

[100] Exh. FS-1 (Jones Test. 8-9).

[101] Exh. T-4 (Hutson Test. 8).

[102] Hutson Tr. 138-39.

other WSS customer has changed any aspect of its WSS contract entitlements or service, removed any base gas from the Washington Storage Field, or otherwise taken any action that would necessitate Transco's purchases of base gas.

89. The WSS Customer Group also asserts that Staff fails to demonstrate that its alternative partial roll-in proposal is just and reasonable.[103] The WSS Customer Group states that Staff witness Radel based her conclusion on a hypothetical premise that there are no replacement shippers for the PSEG and South Jersey Gas capacity entitlements. The WSS Customer Group contends that Fortis and South Jersey have succeeded to the full WSS capacity and deliverability entitlements of their respective releasing shippers PSEG and South Jersey Gas. As such, Transco's current delivery obligations and need for supporting base gas is the same as it was prior to the two permanent release transactions. Furthermore, the WSS Customer Group says that Transco's replacement base gas purchase produced no improvement to the WSS service that historic WSS customers receive. Instead, the purchases helped Transco maintain the same level of service to all WSS customers.[104]

90. The WSS Customer Group contends that Radel's partial roll-in proposal ignores that Transco cannot calculate the amount of base gas capacity necessary to support WSS deliverability until it knows what total top gas capacity and deliverability rights must be supported. The WSS Customer Group states that Radel's proposal also ignores Transco's explanation that, in the event of a base gas repurchase, Transco would confer with its customers to determine whether they wanted to maintain their existing service levels or reduce their service level to a level as low as the level supported by the remaining base gas. The WSS Customer Group contends that Radel's reallocation proposal and Transco's calculation of the additional base gas needed to support service to historic customers are unreliable because they are based on the hypothetical scenario in which there are no replacement shippers for the PSEG and South Jersey Gas capacity entitlements.

91. The WSS Customer Group says that the engineering study that Staff proposes to use to determine the base gas apportioned to each customer[105] is impossible given the constantly shifting top gas inventory levels in the Washington storage field and the non-linear relationship between base gas and WSS deliverability.[106] Transco witness Hutson noted the difficulty in such a study because of the multiple variables involved and the

[103] Exh. S-2; Exh. S-1 (Radel Test. 7-8).

[104] Hutson Tr. 138:1-2.

[105] Exh. S-1 (Radel Test. 11).

[106] Exh. T-4 (Hutson Test. 5).

complexity of operating the WSS storage service.[107] Hutson added that the allocation of costs in rates generally are not determined on the basis of operations.[108]

92. The WSS Customer Group contends that, while Radel's analysis demonstrates that base gas allocable to Fortis and South Jersey supports deliverability to all customers, it ignores the fact that the inverse also is true. Historic customers are responsible for approximately 89 percent of the capacity rights in the Washington Storage Field. Further, total base gas supports the total top gas in the WSS Field.[109] Therefore, the base gas contributions of historic customers provide greater support to Fortis and South Jersey deliverability than the support provided by Fortis and South Jersey's much smaller allocation of base gas provides to historic customer deliverability.

93. Additionally, the WSS Customer Group argues that Radel proposes to shift a significant share of the base gas cost responsibility historically allocated to the capacity rights now held by Fortis and South Jersey to Transco's historic customers. The WSS Customer Group concludes that this reallocation of longstanding, proportional allocations of base gas responsibility among Transco's WSS customers is unjustified and unreasonable.

94. The WSS Customer Group also argues that Fortis and South Jersey's complaint that Transco's ratemaking proposal unduly discriminates against them is unfounded. The WSS Customer Group explains that Transco allocates the costs to operate the WSS storage field to all WSS customers on a ratable basis but allocates the costs of the underlying base gas (taxes and return) to the parties responsible for that base gas. In the case of Fortis and South Jersey, their base gas was recently purchased at a market cost of approximately $6.00 per dekatherm and that is the cost upon which taxes and return are calculated for their service. For other WSS customers, their rates are calculated on the cost of base gas purchased many years ago at lower rates. The WSS Customer Group provides that this approach does not unduly discriminate against Fortis and South Jersey because it is based according to how costs are incurred.

95. Furthermore, the WSS Customer Group points out that Fortis and South Jersey are different than other existing WSS customers in several ways. First, Fortis and South Jersey are new incremental WSS shippers who have not contributed to the costs of base gas needed to operate the Washington Storage Field compared to the other historic WSS customers who have contributed to base gas costs. Second, the base gas that formerly supported the top gas capacity entitlements now held by Fortis and South Jersey was

[107] *Id.* at 5; Hutson Tr. 139:21-25.

[108] Hutson Tr. 139:21-25.

[109] Hutson Tr. 138: 1-2.

purchased by their respective releasing shippers requiring Transco to replenish that base gas. This is not the case with other WSS shippers whose proportional allocation of base gas responsibility was established long ago and continues to support their service.

96. The WSS Customer Group refutes Fortis and South Jersey's complaint that Transco has always "rolled-in" the costs of base gas purchases needed to support WSS service. The WSS Customer Group asserts that Fortis and South Jersey witness Jack N. Jones admitted that his testimony regarding four claimed expansions of the Washington Storage field since 1999 where rolled-in pricing was used was erroneous.[110] Even if it were true, the WSS Customer Group states, this case is distinct from treatment of base gas cost recovery before 1999 as a result of the Commission's adoption of its 1999 Pricing Policy Statement.

97. The WSS Customer Group also notes that the base gas repurchase transactions underlying this proceeding were made in conjunction with the WSS permanent capacity release transactions through which Fortis and South Jersey became WSS shippers. These permanent release/base gas repurchase transactions were specifically designed to extract the value of base gas priced well below current market prices.[111] The parties involved in those transactions seek to mitigate the economic consequences of those transactions, particularly the need to purchase replacement base gas at prevailing market prices, by shifting the costs of these replacement base gas purchases to other WSS shippers.

98. Moreover, the WSS Customer Group argues that, because PSEG and South Jersey Gas's base gas repurchases were the proximate cause of Transco's need to buy an equivalent amount of base gas to support service to their replacement shippers Fortis and South Jersey, it is appropriate for Fortis and South Jersey to bear the costs of that replacement base gas. The WSS Customer Group contends that the South Jersey WSS release and associated base gas repurchase was an affiliate arrangement pursuant to which South Jersey's regulated affiliate and releasing shipper (South Jersey Gas) reaped millions of dollars in economic benefits.[112] The Fortis release transaction was not between affiliates but the underlying motivation for the associated base gas repurchase was the same -- to gain immediate economic advantage by purchasing base gas priced well below the prevailing market price.[113]

99. The WSS Customer Group disputes Fortis and South Jersey's argument that they

[110] Jones Tr. 194:1-10.

[111] Exh. T-14 at 1.

[112] Exh. WCG-2 (Flebbe Test. 14).

[113] Exh. T-14 at 1.

were misled regarding the possibility that they might be asked to pay incremental rates associated with the base gas repurchases by Transco and by the delay in Transco's incremental rate proposal. The WSS Customer Group claims that Transco discussed the need to replace any base gas repurchased by PSEG or South Jersey Gas with both those entities and with their replacement shippers.[114] Also, Fortis and South Jersey are sophisticated entities with substantial experience in the interstate commodity and capacity markets.[115] Additionally, the only witness that Fortis and South Jersey provided in this proceeding was Jones, who has no personal knowledge of the underlying transactions whereby Fortis and South Jersey acquired their WSS capacity.[116] Jones said that the initial rates paid by Fortis and South Jersey for WSS service were based on a prior rate case that was based on the costs of base gas at that time.[117] Further, Jones acknowledged that this docket was the first opportunity for Transco to request cost recovery for its additional base gas purchases associated with providing service to Fortis and South Jersey.[118] As sophisticated market participants, the WSS Customer Group argues, Fortis and South Jersey should have been aware of these facts.

d) New York Public Service Commission

100. The NYPSC does not address this issue.

e) Commission Trial Staff

101. Staff advocates that a portion of the replacement base gas costs should be incrementally allocated to Fortis and South Jersey and a portion rolled-into the WSS/WSS-OA rates of all Washington storage customers. Staff notes that Transco purchased the replacement base gas at a higher price than the price that PSEG and South Jersey Gas paid when they purchased their pro rata share of base gas at historic cost, averaging approximately $0.89 per dekatherm, which is about 10 percent of the current wholesale price of natural gas.[119] Staff explains that without new storage customers to replace the terminated contracts, Transco would have had to purchase 1,320,000 Mcf of base gas to maintain the storage service and top gas capacity entitlements of the historic,

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[114] Exhs. WCG-4, T-10, and T-11; Hutson Tr. 154-55 and 156-57.

[115] Exh. WCG-2 (Flebbe Test. 12-14).

[116] Jones Tr. 210:7-10.

[117] Jones Tr. 201:4-9.

[118] Jones Tr. 200:9-11.

[119] Exh. S-1 (Radel Test. 6); Exh. WCG-1 (Flebbe Test. 3).

non-incremental WSS/WSS-OA customers. [120]

102. Staff proposes that the costs related to the 1,320,000 Mcf of replacement base gas should be rolled-into the rates of all WSS/WSS-OA customers because the costs are independent of the entry of Fortis and South Jersey as storage customers. [121] Staff witness Radel testified that the costs associated with the remaining portion of the 3,366,750 Dth of replacement gas should be charged to Fortis and South Jersey through incremental rates because these costs are directly related to the service provided to Fortis and South Jersey. [122]

103. Staff refutes Transco's argument that, while the quantity of base gas is related to the deliverability of top gas as a result of its integrated storage operations, the Commission has determined that "the integrated operation of a pipeline's facilities is not determinative of cost responsibility."[123] In support, Transco referenced a Commission directive to incrementally charge expansion shippers the cost of additional electric power used to operate certain pipeline compressors even though the compressors were integrated into the Transco system.[124] Staff clarifies that its position is not predicated on integration but based on the principle of cost causation. This principle, which dictates the allocation of costs, is illustrated in Transco's citation to the Commission's approval of rolled-in rate treatment for one compressor where evidence showed no increase in system electric power costs due to that compressor.[125]

104. Staff asserts that that rolled-in rates must satisfy the 1999 Pricing Policy's three-prong test.[126] Staff notes instances in which the 1999 Pricing Policy Statement had been used to directly assign various costs other than pipeline facility costs, including electric power costs. [127]

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[120] Exh. Nos. S-1 (Radel Test. 7) and S-2 at 1; Hutson Tr. 158-59.

[121] Exh. S-1 (Radel Test. 8-9, 11).

[122] *Id.*

[123] Transco Initial Brief 13 (*citing Transcontinental Gas Pipe Line Corp*., 106 FERC ¶ 61,299 at P 115, 123-24 (2004).

[124] *Id.* at 13.

[125] *Id*. at 14 n.17 (*citing Transcontinental Gas Pipe Line Corp.*, 112 FERC ¶ 61,170 at P 105-106 (2005)).

[126] Exh. S-1 (Radel Test. 5-6).

[127] Exh. T-4 (Hutson Test. 7-8); *See Transcontinental Gas Pipe Line Corp. v. FERC*, 518 F.3d 916, 919 (D.C. Cir. 2008) (noting that the application of the 1999

(footnote continued on next page . . .)

105. Staff contends that the first two prongs of the 1999 Pricing Policy Statement are met since a rate increase for historic WSS/WSS-OA customers directly relates to the cost of replacement base gas needed to continue their same level of existing top gas capacity entitlements. Radel testified that Transco would have needed to replace 1,320,000 Mcf of base gas to support and continue the storage service of the historic, non-incremental customers even if there were no incremental customers to replace the terminated contracts. [128] Therefore, a portion of the newly purchased base gas would have been necessary to continue the existing level of storage services for those customers. Without the new base gas purchases, the existing WSS/WSS-OA customers would have had to reduce their level of service. [129]

106. Staff states that the third prong for rolled-in treatment is met because existing WSS/WSS-OA customers would not subsidize Fortis and South Jersey if the costs of 1,320,000 Mcf of base gas are rolled into rates as Radel proposed. Staff claims that there is no subsidization because the historic customers are only paying costs that they would have to pay regardless of whether the replacement shippers were found. [130]

107. Staff also provides that rolling-in the full cost of the 3,366,750 Dth of newly injected base gas to historic, non-incremental customers is unjust and unreasonable because the historical customers would subsidize the incremental customers, Fortis and South Jersey. Service to the incremental customers, Fortis and South Jersey, requires more than the 1,320,000 Mcf of base gas that Transco must purchase to maintain levels of service to historic customers. Subtracting the 1,320,000 Mcf from the full amount of base gas replaced by Transco yields 2,048,777 Dth. Therefore, Staff contends, the costs associated with the additional 2,048,777 Dth needed to serve Fortis and South Jersey should be allocated to them only. [131]

108. Staff adds that, with regards to the 1999 Pricing Policy Statement goal of establishing proper price signals, market conditions have changed and gas is no longer 89 cents per Dt. In 2006, when Transco purchased the new base gas, the average price was

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(. . . footnote continued from previous page)
Pricing Policy Statement is broader than facility capital costs and applies to electric power costs).

[128] Exh. S-1 (Radel Test. 7); Exh. S-2 at 1 (Transco Response to Staff Data Request ARD-3-2).

[129] Exh. S-1 (Radel Test. 7-8).

[130] Exh. S-2 at 1 (Transco response to Staff data request Staff ARD-3-4 b.)

[131] Exh. S-1 (Radel Test. 9).

over $6.00 per Dt. [132] Staff argues that increasing the rates creates an appropriate price signal reflecting the current market value of the gas purchased for the incremental customers.[133]

109. Staff responds to Jones' argument that incremental rates do not send the proper price signal given the substantial economic value to Washington storage customers associated with their option to buy and sell their share of base gas. Staff contends that the economic value that historic WSS customers retained through their purchase option does not affect the price that Transco must pay to purchase replacement base gas. Staff argues that it is the price of replacement base gas needed to meet the storage needs of new customers that, when reflected in rates, sends the proper signal to storage customers. Further, even if Fortis was not told what the price of the storage service would be, they knew, or should have known, that Transco had to purchase new gas at least in part to serve their needs. That knowledge put them on notice that higher rates were likely and should have caused them to inquire as to how high the rates might be if that was of concern.

110. Additionally, Staff explains that rolling-in costs associated with the 1,320,000 Mcf of base gas needed to maintain the historic customers' service level would increase the proposed non-incremental rates by approximately 10 percent. Consequently, Transco's proposed fully incremental rates to Fortis would decrease by about 28 percent and Transco's proposed fully incremental rates to South Jersey would decrease by over 29 percent.[134] Radel argues that Fortis and South Jersey should bear a small allocation of the costs of the 1,320,000 Mcf because they benefit from it. [135]

111. Staff explains that all the costs of the 1,320,000 Mcf should not be borne exclusively by the historic customers; Fortis and South Jersey should have a portion of the costs of the 1,320,000 Mcf allocated to them as well. To determine the costs allocable to Fortis and South Jersey, Radel recommends that Transco perform an engineering study of the Washington storage field to determine the amount of deliverability available to each customer group as a result of the 1,320,000 Mcf so that a precise allocation of the 1,320,000 Mcf between the historic, non-incremental customers and incremental customers could be derived.[136]

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[132] *Id*. at 6, referring to Exh. T-2 at 1, Column C.

[133] Staff Initial Brief 10.

[134] *Id.* at 10-11; Exh. S-3 at 5:12-14.

[135] Exh. S-1 (Radel Test. 11).

[136] *Id.*

112. Staff notes that, although Transco indicated that an engineering study could not be performed,[137] Transco's witness Hutson agreed that if one assumes the costs associated with the 1,320,000 Mcf of base gas should be rolled-in (*i.e*., shifted from Fortis and South Jersey to all of the WSS/WSS-OA customers), one way to assure that Fortis and South Jersey pick-up their share is to spread the costs related to the 1,320,000 Mcf over all customer determinants, including those of Fortis and South Jersey.[138] Hutson agreed that this calculation could be performed by Transco to develop individual Washington Gas storage rates that reflect the support provided to storage deliverability for Fortis and South Jersey as well as the other customers by the 1,320,000 Mcf of additional base gas.[139]

113. Even in the absence of an engineering study, Staff said, an allocation of costs related to the 1,320,000 Mcf of base gas to the historic, non-incremental customers is more appropriate than either full incremental or full rolled-in rates because the historic, non-incremental customers require that amount of base gas to maintain their current level of top gas capacity entitlements even if there are no incremental customers.[140] Additionally, Staff provides that Transco could calculate an adjustment to Staff's allocation in a compliance filing.[141]

114. Staff responds to allegations that its proposal was flawed because it was based on hypothetical assumptions in which no shippers exist to replace the terminated storage services. Staff explains that the purpose of assuming that there were no replacement shippers was to isolate the amount of base gas needed to support and maintain the existing level of storage services of the historic customers in the absence of new customers.

115. Staff notes that Transco's witness Hutson argued that if no replacement shippers existed, Transco would have consulted with its storage customers to determine whether their services could be reduced to a level that could be supported by the base gas remaining after the terminating customers purchased their gas.[142] Staff responds that any discussions with customers that Transco would initiate should there be no replacement shippers are matters of conjecture. Staff adds that no Rate Schedule WSS and WSS-OA

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[137] Exh. T-4 (Hutson Test. 5); Hutson Tr. 168-69.

[138] Hutson Tr. 168-70.

[139] Hutson Tr. 170.

[140] Exh. S-1 (Radel Test. 11).

[141] Hutson Tr. 169-70.

[142] Exh. T-4 (Hutson Test. 3-4).

customer has lowered its top gas capacity entitlements and advocated that costs be allocated according to the base gas calculation that Transco made in its 2007 data response.[143] In any event, Staff claims, any discussions Transco may have with its customers should no replacement shippers exist would almost assuredly create inequities and conflicts among customers and not result in Transco being able to avoid purchasing base gas to maintain storage services. Hutson conceded that even if one or some, but not all, customers agreed to reduce their top gas capacity, those customers would still pay the higher rates needed to cover any additional base gas purchased to meet system top capacity entitlements for those who did not reduce.[144] Staff points out that this would discourage any customer from volunteering to reduce its top gas deliverability entitlements and that Transco would likely still need to purchase the same amount of base gas. Even if some customers reduced their service levels to such an extent that no base gas was needed to replenish the amount purchased by a terminating customer, while those customers would not pay higher rates they would receive a degraded storage service at the same rate.[145] For Transco's customer discussions to yield satisfactory results, all customers would have to reduce their service entitlements on a proportional basis – a very unlikely event given the diverse storage needs of the WSS customers.

116. To Hutson's argument that Transco would need to know its customers' contractual obligations before the amount of base gas to replenish could be determined,[146] Staff argues that it is baseless. Staff alleges that Transco knew the contractual obligations when it responded to Staff's data request in Exhibit No. S-2 and was able to compute a base gas amount that had to be purchased to maintain existing storage services in this proceeding. Further, Staff said that Transco acknowledged that it would always evaluate whether the remaining quantity of base gas (following the purchase of base gas by an exiting customer) is sufficient to support its then-existing contractual obligations.[147]

117. Staff rebukes Hutson's allegation that Radel's testimony is inconsistent. Staff explains that Radel made the assumption that no one subscribes to the released capacity in order to determine the amount of base gas required to be purchased to meet the deliverability requirements of the historical, non-incremental storage customers apart from the base gas needed for Fortis and South Jersey. Staff says that once that amount is determined, however, the top gas capacity of Fortis and South Jersey must then be included as part of the overall top gas entitlements in order to determine how total base

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[143] Exh. S-2 at 3.

[144] Hutson Tr. 162, 163-64.

[145] *Id*.

[146] *Also see* Exh. WCG-2 (Flebbe Test. 3).

[147] Exh. S-2 at 3, 5 (Transco data responses to Fortis-1-11(b) and KEY-1-9).

gas costs should be allocated among all customers.

118. Staff denies Hutson's allegation that the Washington Storage Field's operations do not determine cost allocation, and that the base gas cost investment should be allocated to Fortis and South Jersey since Transco had to purchase the base gas when they became customers. [148] Staff counters that the historic customers caused Transco to incur part of its investment in additional base gas, and that Fortis and South Jersey are not solely responsible for the full additional base gas investment. Staff concluded that ignoring the operation of the Washington Storage Field ignores cost causation and fails to follow the 1999 Pricing Policy Statement. [149]

119. Staff disagrees with WSS Customer Group's contention that Staff should have considered in its methodology what level of base gas would be required to support Fortis and South Jersey's capacity entitlements alone, in the absence of historic customers. [150] Staff explains that it makes little sense to exclude the historic customers in determining whether the most recent shippers should receive incremental rates. Instead, Staff asserts, the appropriate analysis is to consider the impact on base gas purchases with and without the incremental customers, Fortis and South Jersey. Staff contends that a full operability study is unnecessary and that calculations performed by Transco are a sufficient basis on which to allocate costs. Staff adds that witness Flebbe's statement on behalf of WSS Customer Group that Transco's proposal continues the base gas allocation to Fortis and South Jersey that has been in place for 30 years ignores Transco's proposed change in cost allocation that is the subject of this proceeding. [151]

2. Discussion

a) Burden of Proof

120. In determining whether Transco's proposed incremental rate structure is just and reasonable, Section 4 of the Natural Gas Act assigns to Transco the burden of proof.[152]

b) Justness and Reasonableness of Incremental Rates for Fortis and South Jersey

[148] *Id*. at 5-7.

[149] Hutson Tr. 137-38, 148-49, 166.

[150] *See* Exh. WCG-2 (Flebbe Test. 4).

[151] *Id.* at 5.

[152] 15 U.S.C. § 717c(e).

The Washington Storage Field

121. The Washington Storage Field, located in St. Landry Parish, Louisiana, is a vast cavern that Transco opened in 1976[153] and expanded in 1980.[154] The Field is certified to hold a maximum of 120 billion cubic feet (Bcf) of pressurized natural gas.[155] It stores top gas for 31 customers of Transco's WSS and WSS-OA storage service.[156]

122. All of the base gas in the Washington Storage Field supports the top gas deliverability needs of all of Transco's WSS and WSS-OA customers.[157] There is no way to distinguish any molecule of natural gas belonging to any one customer from any other molecule of natural gas belonging to any other customer. Likewise, there is no way to distinguish any molecule of top gas in the cavern from any molecule of base gas.

123. Notwithstanding this indistinguishable quality of gas stored in the Washington Storage Field, Transco maintains an accounting system that allocates quantities of that gas to itself and to its individual customers. The gas that is allocated to customers, known as "top gas," is the quantity of stored gas that each customer is entitled to remove from the Field.[158] 75 Bcf of gas in the Washington Storage Field is allocated as top gas to Transco's customers.[159] The remaining gas, known as "base gas," is owned by Transco and cannot be removed by customers because it is needed to maintain pressure in the cavern and thereby allow the top gas to be removed when called for.[160]

124. Transco's ownership of base gas is subject to one exception—certain customers have specific options to purchase specific quantities of base gas at historical cost if they terminate their storage contracts with Transco. These options are spelled out in Section 9

[153] Exh. T-4 (Hutson Test. 8:11); *Transcontinental Gas Pipe Line Corp.*, 53 F.P.C. 628 (1975).

[154] Exh. T-4 (Hutson Test. 8:18-20); *Transcontinental Gas Pipe Line Corp.*, 12 FERC ¶ 62,287 (1980).

[155] Exh. FS-1 (Jones Test. 24:20).

[156] Exh. FS-18.

[157] *See* Hutson Tr. 141:13-16.

[158] *See* Exh. FS-1 (Jones Test. 24:6-25:5); Exh. FS-7.

[159] Exh. T-4 at 8.

[160] *See* Exh. FS-1 (Jones Test. 23:16-25:5); Exh. FS-7.

of the Transco Tariff's WSS Rate Schedule[161] and Section 8.2 of the WSS-OA Rate Schedule.[162] These options were granted to these customers when the Field opened in 1976 because they were the original customers of the Washington Storage Field who contributed their then-existing gas capacity entitlements to Transco for use in filling the Field with base gas. No other customers have this option.

125. The parties dispute whether Transco can charge "incremental" tariff rates to new customers of the Washington Storage Field that differ from the rates paid by old customers by reason of the far higher prices for injected base gas that Transco had to pay when Fortis and South Jersey came aboard as new customers, compared to the historical cost of base gas already in the Field. The new, higher-priced base gas had to be injected when previous customers PSEG and South Jersey Gas exercised their options under Section 8.2 of the WSS-OA Rate Schedule to purchase and remove base gas at the much lower historical rate, and Fortis and South Jersey replaced them as storage customers in the Field.

126. When Transco initiated this rate case on August 31, 2006, Transco's original proposal was worded in a way that would have permitted it to file a limited NGA Section 4 filing to recover replenishment base gas costs from *all* WSS and WSS-OA customers.[163] However, in the Settlement Agreement that followed that filing on November 28, 2007, Transco changed its proposed language to permit the limited NGA Section 4 filing to recover replenishment base gas costs *only* from new WSS-OA customers who contract for capacity vacated by a terminating customer.[164] This change altered the rate increases that were to be imposed on existing customers and the incremental rates that were to be imposed on Fortis and South Jersey, and was reserved in the Settlement Agreement for resolution in the instant litigation.[165]

"All Base Gas Supports All Top Gas" Means <u>Everybody</u> Must Pay for <u>All</u> Base Gas

127. The regulatory principle that governs this determination, as with many Commission rate cases, is the Commission rule of "cost causation," which requires "that

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[161] Transcontinental Gas Pipe Line Corporation, FERC Gas Tariff, Third Revised Volume No. 1, Fifth Revised Sheet No. 134.

[162] Transcontinental Gas Pipe Line Corporation, FERC Gas Tariff, Third Revised Volume No. 1, Seventh Revised Sheet No. 135F.

[163] *See Transco Notice of Change in Rates*, RP06-569-000, *supra*, Sheet No. 135G, Sections 8.3 and 9.

[164] *See Transco Stipulation and Agreement*, *supra*, Sheet No. 135G, Section 8.3.

[165] *See id*., Art. VII, § A.

all approved rates reflect to some degree the costs actually caused by the customer who must pay them."[166] Compliance with this doctrine is generally evaluated "by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party."[167] "Exacting precision," however, is not required.[168]

128. Here, all parties agree that all base gas benefits the deliverability of all top gas capacity entitlements of all of Transco's WSS and WSS-OA customers.[169] As Fortis and South Jersey's witness Jones testified without dispute, the deliverability of top gas from the Washington Storage Field is a function not just of each customer's independent level of base gas and top gas, but of the overall and collective inventory level of all customers' base and top gas inventory.[170] Jones further stated that associating a discrete level of base gas to any particular customer is merely an accounting proxy on Transco's part that in no way represents the aggregate integrated and dynamic operations of the Field.[171]

129. Since all base gas as a whole serves the top gas capacity and deliverability needs of all customers as a whole, it is impossible to attribute any portion of base gas to any one or more customers in any way other than *pro rata* according to each customer's top gas volume. Other than by its volumetric size relative to others, no one customer's top gas allotment can be said to "cause" more base gas cost than any other customer's. All base gas that is added to the Field contributes to the pressure that is necessary to push all top gas out of the Field. Removing base gas reduces that pressure and diminishes the deliverability of all top gas in the Field.[172]

130. Since no WSS/WSS-OA customer imposes any more burden or draws any more benefit from base gas than any other customer, the principle of cost causation does not support the imposition of an incremental price on new customers based solely on the injection or withdrawal of any given quantity of base gas. When base gas is injected or withdrawn, the top gas capacity and deliverability needs of all customers are affected equally. Thus, when PSEG and South Jersey Gas withdrew their base gas option

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[166] *KN Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992).

[167] *Id*. at 1300-01.

[168] *Midwest ISO System Operators v. FERC*, 373 F.3d 1361, 1368-69 (D.C. Cir. 2004).

[169] Hutson Tr. 137:24-138:2, 141:9-16; Exh. T-4 (Hutson Test. 6:2-5, 9:14-15); Exh. FS-1 (Jones Test. 23:9-15, 25:6-11,28:13-15); Exh. S-1 (Radel Test. 11:5-6).

[170] Exh. FS-1 (Jones Test. 25:6-9).

[171] *Id*. (Jones Test. 25:9-11).

[172] *See* Exh. FS-1 (Jones Test. 23:16-25:5); Exh. FS-7.

entitlements and Transco replenished that base gas with new volumes, Transco did so in order to support the top gas capacity and deliverability needs of all of its customers, not just those of Fortis and South Jersey. *All* service was degraded by the base gas withdrawal, and *all* service was restored by its replenishment.

131. In the face of these straightforward facts, Transco and WSS Customer Group maintain that Fortis and South Jersey should pay "incremental" rates based on the full cost of the replenishment base gas, rather than lower rates based upon a roll-in of that cost with the historic cost of all base gas in the Field, because the succession of Fortis and South Jersey to the delivery entitlements of former customers PSEG and South Jersey Gas caused the need for replenishment base gas, whereas the WSS service of all other customers did not change at all. Essentially, Transco and WSS Customer Group are saying that the withdrawal of PSEG and South Jersey Gas from the Field and their replacement with Fortis and South Jersey were the proximate cause for Transco's purchase of the replenishment base gas—in short, "but for" those events, Transco would not have bought the replenishment base gas.

132. "But for" arguments are appealing, but they tend to mask other impacts that come between the alleged proximate cause and the allegedly injurious effect.[173] Here, the allegation by Transco and WSS Customer Group of the proximate cause for the purchase of replenishment base gas glosses over a number of countervailing considerations. For instance, it is inaccurate to suggest that, "but for" Fortis and South Jersey having stepped into the shoes of PSEG and South Jersey Gas, Transco would *not* have purchased replenishment base gas. Doing so ignores the fact that when PSEG and South Jersey Gas left the Field and took their base gas option amounts with them, service to all customers remaining in the Field was degraded as a result. As Staff points out under its own theory of the case, there is at least a measurable portion of the replenishment base gas purchased by Transco that, even in the absence of Fortis and South Jersey, would have been necessary to inject into the Field anyway in order to restore the top gas capacity and deliverability needs of the remaining customers when PSEG and South Jersey Gas removed their base gas option entitlements.[174] WSS Customer Group similarly admits

[173] *See, e.g.*, *New York Central R. R. v. Grimstad*, 264 F. 334, 335 (2d Cir. 1920) (rejecting argument that barge passenger's drowning would have been avoided "but for" barge owner's failure to provide life-preservers: "[T]here is nothing whatever to show that the decedent was not drowned because he did not know how to swim, nor anything to show that, if there had been a life buoy on board, the decedent's wife would have got it in time . . or, if she had, that she would have thrown it so that her husband could have seized it, or, if she did, that he would have seized it, or that, if he did, it would have prevented him from drowning.").

[174] Exh. S-1 (Radel Test. 8:7-9:15); Exh. T-4 (Hutson Test. 5:21-6:2).

that in the absence of the replenishment base gas, the remaining customers' WSS and WSS-OA service may have been diminished.[175]

133. Transco asserts that before purchasing replenishment base gas, it "would likely consult with its WSS/WSS-Open Access customers to determine whether they desired to maintain their existing service levels or whether they preferred to reduce their existing service levels to a level as low as the level supported by the remaining base gas."[176] This assertion implies that Transco could have avoided at least some of the high costs of replenishment base gas when it replaced the PSEG and South Jersey Gas withdrawals if it had consulted with its remaining customers beforehand to see if they could live with a lower level of base gas service. Thus, Transco may not have needed to buy all of the replenishment base gas that it ended up buying just because of the arrival of Fortis and South Jersey on the scene. This, too, points away from Fortis and South Jersey as the sole "cause" of the replenishment base gas purchase.

134. The WSS Customer Group argues that rolling in the cost of replenishment base gas rather than attributing it all to Fortis and South Jersey significantly diminishes the value of their own base gas purchase options that they possess as original customers of the Washington Storage Field. They point out that the total value of their purchase options is approximately $140 million,[177] and Transco estimates that the roll-in would cost those customers approximately $17.5 million of that amount over Transco's incremental rate proposal.[178]

135. This concern is speculative. The values of the historic customers' options cannot really be known until they are exercised. They may be worth more or less, depending on gas prices at the time of exercise. The options have already been "devalued" by all of the base gas cost roll-ins at successively higher prices that have gone before, whenever Transco has added base gas to the Field in the past.

136. Emphasizing the speculative nature of this argument is the additional contention of Transco and WSS Customer Group that the option-holding customers are unlikely to exercise these options at all. They point out that most WSS shippers are local distribution companies that utilize WSS service to serve their end use customers and are not in the business of looking for price arbitrage opportunities in the interstate capacity markets.[179]

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[175] *See* WSS Customer Group Initial Brief 13.

[176] Exh. S-2 (Response to Staff ARD-3-2).

[177] Exh. WCG-2 (Flebbe Test. 9:15-22).

[178] Exh. T-4 (Hutson Test. 12:5-10).

[179] *See* Exh. T-3 (Hutson Test. 6); WSS Customer Group Initial Brief 19.

Inasmuch as these entities purportedly have little incentive to "cash out" their investment in WSS service, even when prices spike in the commodity market, because to do would require them to relinquish their underlying WSS capacity rights, therefore any decline in the unrealized value of these options as a result of a roll-in of replenishment gas costs is no cause to worry.

137. The fact that the base gas purchase options of WSS Customer Group are diminished by PSEG and South Jersey Gas's exercise of that option and the roll-in of replenishment base gas costs does not upend any settled practice that the parties have observed since the option was first introduced 30 years ago. Quite to the contrary, PSEG and South Jersey Gas have exercised their options exactly as they were intended to be when they were written into the Tariff. Fortis and South Jersey are merely the beneficiaries of that exercise. Transco's practice of rolling-in base gas replenishment costs is the longstanding practice and nothing in the Tariff up to now prohibited Transco from doing so. Having Fortis and South Jersey replace PSEG and South Jersey Gas allows Transco to roll the costs of replenishment base gas into their rates too, not just the rates of the remaining historic customers, which benefits the historic customers by reducing their otherwise higher costs.

138. These considerations suggest that Transco's replenishment base gas purchase was as crucial to meeting the needs of its existing customers as it was to meeting the needs of Fortis and South Jersey. With a little foresight, Transco could have readily avoided at least some of that cost. Therefore, it is cannot be said that the entire need for the replenishment base gas, and the entire resulting cost, could have been avoided "but for" the addition of Fortis and South Jersey as customers.

The 1999 Pricing Policy

139. All parties examine the Commission's 1999 Pricing Policy Statement for support of their respective positions.[180] They acknowledge that it is not directly on point with the facts of this case, but most consider it to contain useful guidance.[181] The Pricing Policy Statement was devised by the Commission in order to assist in determining whether gas pipeline expansion projects should be paid for only by the specific gas customers who use them or all gas customers as a whole. The Pricing Policy Statement covers both operational costs and capital costs of expansion projects and generally seeks to eliminate

[180] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 (1999), *clarified*, 90 FERC ¶ 61,228 (2000), *clarified*, 92 FERC ¶ 61,094 (2000).

[181] *See* Transco Initial Brief 8; WSS Customer Group Initial Brief 6; Fortis/South Jersey Reply Brief 3; Staff Initial Brief 7.

the subsidization by existing customers of such costs that are caused by new customers.[182] As so stated, the Pricing Policy Statement presumptively favors incremental pricing over rolled-in pricing because it expressly protects *existing* customers from subsidizing *new* customers rather than the other way around.

140. But the Pricing Policy Statement's presumption in favor of incremental pricing is rebuttable. The Pricing Policy Statement determines which way the subsidy is going to go depending on three factors that, if found to be true in a particular instance, militate toward rolled-in rates: (i) whether new facilities are needed to improve service to existing customers; (ii) whether increased rates are related to improvements in service; and (iii) whether raising rates to existing customers would not constitute a subsidy to new incremental customers.

141. The parties diverge most widely over the first factor. They dispute whether the addition of replenishment base gas after PSEG and South Jersey Gas exercised their base gas purchase options constitutes an "improvement in service" to the existing customers such that rolled-in rates would be more appropriate than incremental rates. To Fortis and South Jersey, the replenishment base gas improves service to existing customers because, without it, service to those customers would be degraded. To the existing customers, the replenishment base gas constitutes no improvement at all, but merely a continuation of the same service that they already have. To Staff, the answer lies somewhere in between; at least part of the replenishment base gas, but not all of it, constitutes an improvement in service for existing customers because, without Fortis and South Jersey, Transco would have had to inject at least some, but not all, of the replenishment base gas that it actually injected in order to prevent a degradation of existing service.

142. In applying this factor of the Pricing Policy Statement, all of the parties focus on the replenishment base gas as if it alone were an "expansion facility" of the type that the Pricing Policy Statement was designed to assess. This focus misses the mark. The Washington Storage Field is a single, indivisible facility—a big cavern filled with pressurized natural gas. The natural gas in the cavern is itself physically indivisible. On Transco's books it is subdivided into "top gas" and "base gas," and the top gas is allocated to individual customers. That division is made on Transco's books only to keep track for accounting purposes of how much gas each customer has in storage and is entitled to remove from the Field. But in reality, it is impossible to differentiate the gas of one customer from the gas of another customer in the cavern, or to differentiate a molecule of "top gas" from a molecule of "base gas."

143. Thus, in real terms, neither the totality of the base gas in the Field nor any portion

[182] *Transco v. FERC*, No. 06-1286, slip op. at 5 (D.C. Cir., March 7, 2008).

of it is a separate "facility" that serves some customers and not others. All of the base gas and every part of it are *components* of the overall "facility"—the Washington Storage Field—that provides an integrated storage service to all of its customers.[183] There has been no "expansion" of that facility within the set of facts in this case. The replenishment base gas that was injected into the Field when PSEG and South Jersey Gas left, and Fortis and South Jersey took their places, is not a separately identifiable "expansion" facility in and of itself. It is part and parcel of the pre-existing facility and it supports the storage needs of old and new customers equally.[184]

144. Hence, when evaluating under the first factor of the Pricing Policy Statement whether the "new facilities" in question are "needed to improve service to existing customers," the fact of the matter is that the replenishment base gas is not a "new facility" in the first place. As a mere component of an existing facility, the replacement base gas, like all base gas, serves the top gas needs of both new and existing customers alike. It is not directed toward "improving service" to *existing* customers any more than it is directed to "improving service" to *new* customers. It is directed to *maintaining* service to *all* customers alike. Realistically, therefore, the first factor of the Pricing Policy Statement does not help our determination one way or the other and does not really fit this case.

145. Transco and WSC Customer Group point to the Commission's 2004 decision, affirmed in 2008 by the U.S. Court of Appeals for the D.C. Circuit, regarding Transco's Cherokee and SouthCoast expansion facilities to show that the Pricing Policy Statement is applicable to operating cost components of facilities, such as the base gas of the Washington Storage Field, as well as to whole facilities in determining whether incremental pricing or rolled-in pricing is appropriate.[185] In that case, the Commission rejected system-wide rolled-in pricing and ordered incremental pricing for new customers of the fuel and electricity charges of the Cherokee and SouthCoast compressor expansion projects. The Commission found that charging system-wide rates to incremental shippers would result in the existing shippers subsidizing expansion shippers in contravention of the 1999 Pricing Policy Statement.[186] In so doing, the Commission noted Transco's concession that "there is no question that Transco can determine how much fuel or electric power is used to operate any particular compressor unit over a particular time."[187]

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[183] *See* Hutson Tr. 138:15-21; 168:13-21.

[184] *See* Hutson Tr. 168:13-21.

[185] *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299 (2004); *aff'd sub nom. Transco v. FERC*, 518 F.3d 916 (D.C. Cir., March 7, 2008).

[186] *Transcontinental Gas Pipe Line Corp. supra,* 106 FERC ¶ 61,299 at P 122.

[187] *Id*. at P 124.

146. Here, however, unlike the Cherokee and SouthCoast expansion facilities, none of the parties have devised a foolproof way to parse the cost of base gas among the WSS and WSS-OA customers who rely on it. The base gas in the Washington Storage Field is an indivisible component of that facility, which serves all of the top gas capacity needs of all of Transco's WSS and WSS-OA customers.[188] This is not the same circumstance as the Cherokee and SouthCoast compressors that served only new customers *and that old customers had no need for*, which prompted the Commission (and the D.C. Circuit on appeal) to reject rolled-in pricing in favor of incremental pricing.[189]

147. The second factor of the Pricing Policy Statement, whether increased rates are related to improvements in service to existing customers, is equally inconclusive in this case. A rolled-in rate treats the entire cost of service attributable to the Washington Storage Field as the indivisible facility that it is. The capital investment in replenishment base gas was absolutely necessary for Transco to make in order to serve all of its customers, because it is contractually obligated to support the top gas storage requirements of all of its customers and a failure to make that investment would have led to a diminishment of that service.[190]

148. Therefore, charging a higher rate to new customers than is charged to historical customers would bear no relationship whatsoever to all or any part of the Washington Storage Field service, whereas charging the *same* rate to new and historical customers alike is directly reflective of the indivisible nature of the service that is provided to all customers by the Washington Storage Field. The rate increase proposed in this case relates only to *existing* service that is due to *all* Transco storage customers; it is misleading to attribute this increase to nonexistent "improvements" in service. Thus, the second factor of the Pricing Policy Statement does not help decide this case either—it is a red herring.

149. As for the third factor, it cannot be said that rolling-in rates would result in a "subsidy" of new customers by old customers because there is no real way to parse the cost of base gas between them. All base gas serves all top gas;[191] it follows, therefore, that no one customer's top gas allotment can be said to cause more base gas cost than any other customer's. Likewise, the replenishment of base gas withdrawn by PSEG and South Jersey Gas when they terminated their WSS-OA service, and Fortis and South

[188] *See* Hutson Tr. 141:13-16.

[189] *Transco v. FERC, supra* at 919-20.

[190] *See* Hutson Tr. 137:16-138:2.

[191] *See* Hutson Tr. 138:1-2.

Jersey took their places, cannot be attributed to the top gas capacity and deliverability needs of any one group of customers any more than it can be attributed to the needs of any other group of customers. Incremental rates, by contrast, *unquestionably* impose a subsidy that Fortis and South Jersey would have to pay for the benefit of pre-existing customers, who count for approximately 89 percent of the capacity rights in the Washington Storage Field.[192] This is so because, in so doing, Fortis and South Jersey would be paying the whole cost for replenishment base gas that serves the needs of historic customers as well as themselves. The third factor of the Pricing Policy Statement, therefore, favors rolled-in rates.

150. In sum, under the facts of this case, including in particular the undisputed fact that all base gas indivisibly supports the top gas deliverability needs of all customers, the 1999 Gas Pricing Policy Statement (in particular, the third policy factor alone) weighs against the showing that Transco must make that its incremental pricing proposal is just and reasonable, to the extent that it applies at all here.

Price Signals

151. Staff maintains that creating incremental rates for incremental customers that reflect the current market value of the gas purchased for their benefit is consistent with the 1999 Pricing Policy goal of sending an appropriate price signal to those customers by increasing their rates to account for this cost increase.[193] Fortis and South Jersey reject this contention on the ground that they are not "new incremental customers," only "replacement" customers who only agreed to pay the fully rolled-in rates of their predecessors.[194]

152. When the Commission implemented the 1999 Pricing Policy Statement, it spoke of price signals in the following terms:

> The current pricing policy [favoring rolled-in rates for expansion facilities over incremental rates] sends the wrong price signals, as some commenters have argued, by masking the real cost of the expansions. This can result in overbuilding of capacity and subsidization of an incumbent pipeline in its competition with potential new entrants for expanding markets. The pricing policy's bias for rolled-in pricing also is inconsistent with a policy that encourages competition while seeking to provide incentives for the optimal

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[192] *See* WSS Customer Group Initial Brief 8.

[193] Exh. S-1 (Radel Test. 6); Exh. T-2 at 1 (Column C); Staff Initial Brief 10.

[194] Fortis/South Jersey Reply Brief 6.

> level of construction and customer choice. This is because rolled-in pricing often results in projects that are subsidized by existing ratepayers. Under this policy the true costs of the project are not seen by the market or the new customers, leading to inefficient investment and contracting decisions. This in turn can exacerbate adverse environmental impacts, distort competition between pipelines for new customers, and financially penalize existing customers of expanding pipelines and of pipelines affected by the expansion.[195]

153. As explained above, the concerns about price signals voiced by the Commission in the 1999 Pricing Policy Statement are not present here because the replenishment base gas purchased for the Washington Storage Field is not an "expansion facility." It is merely a component of an existing facility; no "expansion" whatsoever has occurred under the facts of this case. The Commission's 1999 Pricing Policy Statement aims at making customers who require gas pipeline facility expansions pay the full cost of those expansions under the principle of cost causation and sparing existing customers who do not need the expansions in order to continue the same level of service. It does not aim at allowing existing customers to avoid paying for their fair share of the ordinary costs of non-expanding facilities. Accordingly, to the extent that the incremental rate proposed here is premised on the notion that it sends a more appropriate "price signal" than a rolled-in rate would, it is misplaced and must be rejected.

154. WSS Customer Group also argues that directing rolled-in treatment for incremental base gas purchases in the Washington Storage Field, which is located in the same geographic region as many of the newly certificated or pending market-based rate storage facilities, sends an improper price signal to both potential incremental WSS shippers as well as the market for production area storage capacity in general. This results, they say, from the fact that a roll-in of base gas costs associated with Fortis and South Jersey capacity will artificially reduce the costs to Fortis and South Jersey of obtaining production area incremental storage capacity well below the comparable costs that must be paid by other production area storage customers, and will do so at the expense of historic WSS shippers.[196] WSS Customer Group maintains that this result is contrary to the Commission's policy on market-based rates for incremental storage facilities as well as the rationale underlying Section 312 of the Energy Policy Act of 2005–namely, that it is in the public interest to promote the construction of additional natural gas storage facilities within the United States and that market-based rates promote

[195] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶61,227 at 61,745 (1999).

[196] WSS Customer Group Initial Brief 8-9.

such construction.[197]

155. Fortis and South Jersey reject WSS Customer Group's contention on the ground that rolled-in rates simply reduce their storage expenses, enabling them to reduce the prices of supply to their gas customers and strengthening their ability to compete for gas markets on an even footing with the other WSS-OA customers, as well as for additional storage capacity that comes available in the Washington Storage Field.[198] Staff also counters that WSS Customer Group's argument is misplaced because Transco has cost-based storage rates and has no market-based rate authority. Thus, Staff maintains, WSS Customer Group's contention premised on market-based rates simply does not apply here.[199]

156. There is no evidence in the record regarding either the actual or relative costs of other production-area storage providers, so WSS Customer Group's contention is unsubstantiated. What is more, the possibility that WSS-OA storage may be cheaper than other storage providers in the region who use market-based rates does not counter Commission policy favoring new storage construction by promoting market-based rates. Transco's rate is simply one competitive price among many in the regional gas storage market, which is all that the Commission's market-based rate policy provides to participants as an incentive to new construction.

What Fortis and South Jersey Originally Agreed To

157. Transco and WSS Customer Group disagree with Fortis and South Jersey's claim that they only agreed to pay Transco's maximum WSS-OA rate existing at the time that they became replacement shippers for PSEG and South Jersey Gas, and that they did not agree to pay incremental rates as Transco now proposes. The WSS-OA Tariff, Transco and WSS Customer Group point out, contains a "*Memphis* clause"[200] which states that Fortis and South Jersey:

> shall pay Seller for natural gas service rendered hereunder in accordance with Seller's Rate Schedule WSS-Open Access, and the applicable provisions of the General Terms and Conditions of Seller's FERC Gas

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[197] *Id*.

[198] Fortis/South Jersey Reply Brief 8-9.

[199] Staff Reply Brief 5.

[200] Named for its progenitor, *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103 (1958).

> Tariff as filed with the Federal Energy Regulatory Commission, and as the same may be amended or superseded from time to time.[201]

158. This provision, Transco and WSS Customer Group maintain, is standard tariff language that authorizes Transco to propose unilateral rate changes pursuant to NGA Section 4. They contend that Fortis and South Jersey were on notice (or at the very least should have been) at the time they entered into their service agreements that Transco had this right to change their rates, and their argument that their contracts somehow limit Transco to having a single rate applicable to all WSS-OA service is inconsistent with the explicit language of their service agreements, as well as with Transco's right under NGA Section 4 to propose changes to its rates under its Rate Schedule WSS-OA.

159. Transco and WSS Customer Group are correct in observing that the "*Memphis* clause" affords Transco the right to unilaterally propose rate changes to the WSS-OA Tariff. That does not, however, limit the authority of the Commission to adjudicate the justness and reasonableness of the proposed rate, nor does it limit the right of Fortis and South Jersey to petition the Commission to deny the proposed rate change on the ground that it is unjust and unreasonable. This clause speaks only to what Transco is entitled to do, and casts no restraint on those customers' rights or the Commission's determination of what is just and reasonable in this case.

160. The fact that Fortis and South Jersey are sophisticated entities with substantial experience in the interstate commodity and capacity markets who have reaped millions of dollars in economic benefits from these transactions[202] does not justify changing the rate structure either. Just because they are smart does not mean that Transco does not have to be "just and reasonable" in setting rates. Fortis and South Jersey's predecessors made proper use of tariff provisions that the historical WSS customers enjoy as well. Up to now, those tariff provisions were silent as to the manner in which the costs of a terminating customer's exercise of those provisions were to be allocated to non-terminating customers. That blank can be filled in now by the establishment of a cost allocation methodology, but it must be a "just and reasonable" one, regardless of any particular customer's degree of sophistication or lack thereof. An incremental rate scheme simply does not pass that test.

Staff's Alternative Proposal—Part Roll-in, Part Incremental

161. Staff proposes an alternative to Transco's incremental pricing proposal that

[201] Exh. T-8 and T-9, Article IV.

[202] *See* Exh. WCG-2 (Flebbe Test. 12:17-14:21).

involves attributing to non-incremental customers a portion of the new base gas that was injected into the Field upon Fortis and South Jersey's arrival and the remainder to Fortis and South Jersey. This alternative is premised on the assumption that if Fortis and South Jersey did not become customers, at least some of the new base gas would have had to be injected anyway in order to support the top gas deliverability needs of the remaining customers when PSEG and South Jersey Gas exercised their base gas purchase options.

162. Staff's proposal is based on Transco's estimate, offered during discovery, of the amount of replenishment base gas that Transco would need to inject into the Washington Storage Field to support the existing customer's top gas deliverability needs if the top gas attributable to Fortis and South Jersey were not present. This amount comes to 1,320,000 Mcf of base gas, which Staff has converted into dekatherms and subtracted out an amount attributable to Merrill Lynch's base gas allocation to arrive at 1,317,973 Dth of base gas that would be needed if Fortis and South Jersey's top gas were absent.[203] This quantity is about one-third of the total amount of 3,366,750 Dth of replenishment base gas that was actually injected into the Washington Storage Field to support all existing customers, including Fortis and South Jersey.[204] According to Staff, the 1,317,973 Dth represents the portion of the purchased replenishment base gas that should be attributed to the historic customers and should be paid for by them at Transco's replenishment cost, and the difference between that amount and the 3,366,750 Dth total volume of replenishment base gas that Transco actually purchased, a remainder of 2,048,777 Dth, should be attributed to Fortis and South Jersey and should be paid for by them at Transco's replenishment cost.[205]

163. Staff's proposal is a reasonable attempt to "split the baby" between the competing sides in this case, but it is untenable for the same reason that that Transco's proposal does not work. All base gas is indivisible and supports all top gas deliverability needs of all customers. Thus, Staff's proposal fails the principle of cost causation just as much as Transco's does, because it also draws a boundary that does not exist in reality.

164. In fact, Staff's proposal underscores why rolled-in rates make more sense than incremental rates in this case. It is based on a Transco estimate of how much base gas would have to be injected into the Field in order to support the top gas deliverability needs of the existing customers without Fortis and South Jersey, but Transco does not vouch for the accuracy of that estimate. Staff does not either; instead, Staff would prefer that an engineering study would be performed to determine precisely what the correct

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[203] Exh. S-2 (Response (b) to Staff ARD-3-2); S-1 (Radel Test. 9:1-15).

[204] Exh. S-1 (Radel Test. 9:11-15).

[205] Exh. S-1 (Radel Test. 9:1-15); Exh. S-3.

volume would be.[206] Transco counters, however, that such a study may not be possible because the relationship of base gas requirements to top gas needs is "non-linear" and subject to constantly shifting top gas inventory levels in the Field.[207]

165. As there is no universally-accepted way to allocate particular base gas volumes to particular top gas deliverability needs, Staff's proposal fares no better than Transco's in parsing the cost of replenishment base gas. We are left with the unitary treatment of all base gas as being attributable to the deliverability needs of all top gas customers as the only appropriate way to apportion this cost among customers.

Discrimination

166. Rates not only must be shown to be just and reasonable; Section 4 of the NGA also requires that they be nondiscriminatory.[208] As the Commission has held, "[a] mere difference in treatment between customers is not unduly discriminatory if the customers are not similarly situated, and thus there is a rational basis for the difference."[209]

167. In this connection, Transco and WSS Customer Group argue that Fortis and South Jersey are replacement shippers for whom Transco had to buy replacement base gas in order to provide their service, and therefore that they are not similarly situated to the non-incremental WSS customers for whom Transco did not have to incur the costs in question.

168. Fortis and South Jersey dispute Transco's characterization of their uniqueness as customers, contending that Transco never imposed such incremental rates for replacement base gas on replacement customers before, and instead charged such customers rolled-in rates whenever replacement base gas was purchased.[210] Transco retorts that it never had to charge incremental rates before because the examples Fortis and South Jersey have cited all happened before 1999, prior to the Commission's change

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[206] Exh. S-1 (Radel Test. 11:6-10).

[207] Exh. T-4 (Hutson Test. 5:5-10).

[208] 15 U.S.C. § 717c(b).

[209] *Tenn. Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,245 (1997); *see also Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305, 1316 (D.C. Cir. 1991).

[210] *See* Hutson Tr. 143:13-145:1.

in pricing policy from favoring rolled-in rates to favoring incremental rates.[211]

169. The fact that the Commission's 1999 Pricing Policy Statement generally favors incremental pricing over rolled-in pricing with regard to gas expansion facilities does not prove dispositively that Transco's proposed incremental rate is non-discriminatory. As demonstrated earlier herein, the 1999 Pricing Policy Statement as applied to this specific case (if, indeed, it is applicable at all) leads to the conclusion that rolled-in pricing is more appropriate here than incremental pricing. Therefore, the general approach of the 1999 Pricing Policy Statement does not apply to this issue.

170. As for Transco's defense of its differential treatment of Fortis and South Jersey on the ground that they are not similarly situated to all other customers in the Washington Storage Field because they are "replacement shippers for whom Transco had to buy replacement base gas," that view clashes with Transco's assertion that Fortis and South Jersey have "stepped into the shoes" of their predecessors, PSEG and South Jersey Gas.[212] By "stepping into their shoes," Fortis and South Jersey should be treated no differently from PSEG and South Jersey Gas when they were active storage customers, who paid Transco the same storage rate as all other customers. Merely having replaced PSEG and South Jersey Gas in the same capacity is no rational basis for making Fortis and South Jersey pay more than other customers for the exact same service that all receive.

171. It is equally no distinction worthy of differential treatment that Fortis and South Jersey did not contribute to past costs of base gas needed to operate the Washington Storage Field that were paid by historic WSS customers who contributed to the Field's initial base gas costs. Fortis and South Jersey's predecessors, PSEG and South Jersey Gas, did so contribute during the entire time period during which they were customers. Fortis and South Jersey are at a competitive disadvantage to the historic customers in that they do not enjoy the right they own of being able to purchase base gas at historic cost. This disadvantage does not justify making Fortis and South Jersey even worse off compared to historic customers by unfavorable differential rate treatment.

172. This lack of rational basis for treating Fortis and South Jersey differently from all other customers is underscored by the treatment of another replacement storage customer in the same position that they are in, Merrill Lynch. Merrill Lynch replaced Columbia Gas of Virginia upon its termination of WSS service and release of WSS storage capacity.[213] Upon its termination, Columbia Gas of Virginia purchased 46,596 Dth of

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[211] *See* Transco Reply Brief 4.

[212] *See*, *e.g.*, Hutson Tr. 141:3-8; 165:5-8.

[213] *See* Transco Reply Brief 6-7.

base gas from Transco.[214] In its initial August 31, 2006 rate increase filing in this case, Transco proposed incremental WSS-OA rates to recover the cost of replenishment base gas attributable to Merrill Lynch that were similar to those proposed for Fortis and South Jersey.[215] In the November 28, 2007 Settlement Agreement, however, Transco settled for rolled-in rates from Merrill Lynch.[216] The parties stipulated for the purposes of this case that the incremental base gas purchases attributed to Merrill Lynch and the associated billing determinants are to be treated on a non-incremental basis.[217]

173. As the Commission has routinely pointed out with this and all settlement agreements, the Commission's approval of a settlement agreement "does not constitute approval of, or precedent regarding, any principle or issue in this proceeding."[218] Likewise, the differing treatment of Merrill Lynch is neither approved of nor precedential here. It is, however, illustrative of the fact that replacement shippers who are similarly situated to Fortis and South Jersey are subject to differing treatment by Transco under its incremental rate proposal.

174. This potential for widely differing treatment of similarly-situated customers is particularly true given the fact that Transco's proposed amendment to Section 8.3 of the WSS-OA Tariff for the purpose of implementing incremental rates in the future provides that Transco "*shall have the right to make* a limited Section 4 rate filing to recover from the new Buyer(s) any increase in the cost of service attributable to [Transco's] replenishment of Base Gas to serve the new Buyer(s)."[219] The necessary negative implication of this language is that Transco may arbitrarily choose to impose incremental rates on *some* new buyers *and not others*, including those similarly situated to Fortis and South Jersey. This situation creates uncertainty among buyers as to whether they will be

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[214] Exhs. FS-1 (Jones Test. 9:19-10:9); FS-2 ("0307" column); FS-3.

[215] *Transco Notice of Change in Rates*, RP06-569-000, *supra*, Sheet No. 27A and Exh. T-1, Statement I, Page 31 and Schedule J-2, Page 25 (August 31, 2006) (Statement I reflects the incremental allocation of costs to Entergy-Koch, and Schedule J-2 reflects the incremental rate design for Entergy-Koch).

[216] *Transco Stipulation and Agreement*, at 30 (November 28, 2007) (providing in Art. III, Section C that the incremental rate applicable to Entergy-Koch was modified such that the generally applicable rates under Rate Schedule WSS-OA apply to Entergy-Koch and its successor, Merrill Lynch).

[217] Exh. J-1.

[218] *Transcontinental Gas Pipe Line Corp.*, 122 FERC ¶ 61,213, at P 11 (2008).

[219] *Transco Stipulation and Agreement*, *supra*, Sheet No. 135G (Section 8.3) (emphasis added).

subjected to incremental rates or not, which is not an appropriate purpose for a tariff.[220]

175. The fact that Transco "had to buy replacement base gas" for Fortis and South Jersey also fails to justify charging them different rates from the other WSS-OA customers. The incremental rate that Transco proposes to charge them because of this fact is structurally no different from the rate that other storage customers pay, in that it is designed to reimburse Transco only for its Commission-approved rate of return on its capital investment of base gas in the ground plus applicable taxes thereon.[221] It does not reimburse Transco for its full cost of purchasing replacement base gas, which is far higher. Transco does not charge any storage customer for that direct cost, either in the form of a bill for the entire amount or by including the depreciation of that cost in the cost of service embedded in the WSS-OA rate.[222] Transco has absorbed significant upward movements in the price of base gas entirely on its own in its past transactions in this business.[223] The cost to Transco of the replacement base gas that it purchased when PSEG and South Jersey Gas left the Field totaled $20,470,313.[224] By contrast, the total return and taxes thereon that Transco expects to receive through its WSS-OA rates from all of its storage customers for its total capital investment in base gas in the Field is only $6,727,220.[225]

176. The principal portion of the WSS-OA rate that relates to Transco's base gas investment recovers Transco's Commission-approved return on equity (ROE), which typically compensates Transco for the time value of money. ROE has been characterized

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[220] *See Tarpon Whitetail Gas Storage, LLC*, 123 FERC ¶61,274, at P33 (2008) ("[T]he tariff should provide for rate certainty."); *also see Pennsylvania R. Co. v. International Coal Mining Co.*, 230 U.S. 184, 206 (1913) (Coal company accuses railroad of discrimination in granting illegal rebates to competitors from filed tariff rates and demands damages equal to the rebates granted to others; Court holds that "[t]o adopt such a rule and arbitrarily measure damages by rebates would create a legalized, but endless, chain of departures from the tariff" and "would destroy the equality and certainty of rates . . . .").

[221] Flebbe Tr. 185:9-17.

[222] *See* Hutson Tr. 175:7-11; Flebbe Tr. 185:9-17 (cost of base gas not recovered by Transco through depreciation in cost of service rates).

[223] *See* Hutson Tr. 142:4-145:1; Exh. FS-17.

[224] *See* Exh. S-3, p. 1 (total of base gas purchase for S. Jersey of $9,786,634.00 plus base gas purchase for Fortis of $10,683,679.00); *also see* Exh. FS-4, p. 1, line 3, column d.

[225] *See* Exh. FS-11, p. 1, line 4 column C.

in past Commission cases as "a marginal opportunity cost that should equal the higher of the cost of a utility's worst debt or the return available on its best available investment."[226] Clearly, Transco's "best available" alternative investment would be to sell off its base gas in the marketplace (if only it had no contractual constraints against so doing). Given Transco's historic average base gas cost and current market prices, such a sale would fetch Transco a handsome profit margin of approximately 630 percent, far more than its Commission-approved ROE that it now receives on that gas volume of only 11.75 percent.[227]

177. The very limited recoupment capability of the ROE portion of the WSS-OA storage rate shows that it is by no means an appropriate vehicle for Transco's recovery of base gas purchase costs that it is contractually required to bear. This fact negates any rational basis for using it as a vehicle for recovering all or even any part of Transco's cost of buying replacement base gas solely from Fortis and South Jersey. The only proper purpose of the ROE portion of the WSS-OA storage rate is to reimburse Transco for the opportunity cost of keeping the base gas in the ground rather than selling it off. Transco's business of buying and selling base gas is a separate business altogether, over which Transco assumes all the risks and reaps all the benefits. Transco does not allocate costs from that business to its WSS customers or credit revenues from that business to them. Having to purchase replacement base gas when PSEG and South Jersey Gas left was handled by Transco entirely through that separate business, so there is no reason to attribute any of the financial needs of that business operation specifically to Fortis and South Jersey.

178. Since the rate structure for WSS-OA service performs the same role for Fortis and South Jersey as they do for other Transco customers—that is, it only pays Transco for its opportunity cost of keeping base gas in the ground rather than withdrawing it and selling it—therefore Fortis and South Jersey are similarly situated to the other customers in that respect and must be treated non-discriminatorily for ratemaking purposes.[228] By contrast,

[226] *See*, *e.g.*, *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,219, at 61,774 (2004).

[227] This is the midpoint of the results of two calculations in the record: Exh. WCG-2 (Flebbe Test. 9:15-22); [$6.00/Dth (current gas price) - $0.89/Dth (average historic cost of base gas) / $0.89 (average historic cost of base gas)] x 100 = 574 percent; *also see* FS-1 (Jones Test. 12:19-22); Exh. FS-4 at 1:13; [$7.0000 (current gas price) - $0.8928 (average historic cost of base gas) / $0.8928 (average historic cost of base gas)] x 100 = 684 percent.

[228] *Tenn. Gas Pipeline Co., supra*; *Algonquin Gas Transmission Co. v. FERC, supra*.

Transco's proposed incremental rates attempt to force Fortis and South Jersey to pay *more* of Transco's opportunity cost than the remaining customers pay for the exact same service, while not even coming close to making up for the shortfall in Transco's unrecovered opportunity cost or its replacement base gas purchase cost. The remedy, in other words, does not cure the disease. Transco cannot penalize Fortis and South Jersey for the fact that its WSS-OA rate structure is not designed to meet these economic needs.

179. Thus, the incremental rates have no rational basis in a legitimate difference between Fortis and South Jersey on the one hand and all other customers on the other, and therefore are unlawfully discriminatory under NGA Section 4.

c) Conclusion

180. Transco having not met its burden of proving that its proposed incremental rate proposal is just and reasonable, and having found Staff's counterproposal to be untenable, we are left with the rate structure that has always been applied in the Washington Storage Field, which is to roll in the costs of newly-injected base gas with all existing base gas costs and to attribute those costs equally to all storage customers.

B. Issue: *Whether Fortis and South Jersey have established that the existing base gas purchase option under Section 8.2 of Transco's Rate Schedule WSS-OA is unjust and unreasonable.*

1. Positions of the Parties

a) Transco

181. Transco argues that Fortis and South Jersey's proposal to eliminate or modify the WSS base gas purchase option is improper and fails to satisfy the burden of proof imposed by NGA Section 5.[229] Transco explains that, in order for Fortis and South Jersey's proposal to be considered, they must demonstrate that the provision in the Agreement identifying Transco's incremental pricing proposal as the sole issue to be reserved for hearing "seriously harms the public interest."[230] Transco contends that the District of Columbia Circuit recently determined that the requirement to satisfy the public interest standard in order to modify a Commission-accepted settlement applies equally to proposals that would modify or "supplement" the settlement.[231]

[229] Exh. FS-1 (Jones Test. 4, 38-39).

[230] *Dominion Transmission, Inc. v. FERC*, 533 F.3d 845, 853 (D.C. Cir. 2008).

[231] *See id.* at 853.

182. Transco contends that it is improper for Fortis and South Jersey's proposal to be considered in this proceeding because it is inconsistent with the Settlement. Article VII, Section A of the Settlement, to which Fortis and South Jersey are parties, identified the only issue in this proceeding that the participants reserved for resolution pursuant to hearing or further settlement:

> "[T]he issue of Transco's proposal under NGA Section 4 to establish incremental rates under Rate Schedule WSS-Open Access applicable to Cinergy Marketing & Trading, LP (and its successor [Fortis]) and [South Jersey] to recover Transco's cost of purchasing replenishment base gas.[232]

183. Transco underscores that Fortis and South Jersey joined in the Settlement despite the absence of any provision reserving their Section 5 proposal for separate resolution. Therefore, Transco argues, Fortis and South Jersey's Section 5 proposal is barred by the explicit terms of the Settlement and its consideration is inconsistent with "the public interest goal of preserving the sanctity of Commission-approved settlements and contracts."[233]

184. Transco notes Fortis and South Jersey's Section 5 proposal is properly viewed as a proposed modification of the Settlement, specifically an expansion of the scope of the issue the participants agreed to reserve for litigation. Transco adds that the Settlement states that any proposed change to it may only be considered under the "public interest standard" of the *Mobile-Sierra* doctrine.[234] Accordingly, Transco claimed, such a modification of the Settlement requires a demonstration that the challenged term of the agreement "seriously harms the public interest." *Dominion Transmission, Inc. v. FERC,* No. 07-1065 at 13 (D.C. Cir. 2008).

185. Moreover, Transco asserts that Fortis and South Jersey's proposal is irrelevant to this proceeding because it addresses future potential events that have no bearing on their Rate Schedule WSS-OA rates that will result from litigation of the reserved issue. Transco underscores that it is irrelevant to examine a prospective event that will have no effect on the reserved issue in this proceeding regarding the allocation of the gas purchase costs that Transco has already incurred.

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[232] *Transco Stipulation and Agreement, supra,* Art. VII, Section A.

[233] *Sunoco, Inc. v. Transcontinental Gas Pipe Line Corp.*, 114 FERC ¶ 61,180, at P 42 (2006).

[234] *See FPC v. Sierra Pacific Power Co.,* 350 U.S. 348, 355 (1956), *United Gas Pipe Line Co. v. Mobile Gas Serv. Co.,* 350 U.S. 332 (1956).

b) Fortis and South Jersey

186. Fortis and South Jersey argue that they meet the two-pronged burden of proof under Section 5 of the NGA in showing that the base gas purchase option is unjust and unreasonable, and that both of their proposed remedial options are just and reasonable. Fortis and South Jersey explain that Section 8.2 allows certain named storage customers to purchase a defined quantity of base gas from the Washington Storage facility when those customers terminate or permanently release their service. Currently, all but 3 of 31 WSS-OA customers have this purchase right; the aggregate amount of WSS-OA base gas now subject to purchase is approximately 25.9 Bcf.[235] Fortis and South Jersey recommend that the Commission either require Transco to eliminate the base gas purchase option altogether or circumscribe it, such that storage customers who desire to purchase their allocated base gas quantity may do so only when Transco reduces the certificated capacity of its WSS-OA storage service.

187. Fortis and South Jersey add that Section 8.2 has lost relevance since its creation in the 1970's and has had significant deleterious consequences for WSS-OA storage customers since then. Furthermore, Fortis and South Jersey contend that the purchase provision has increased Transco's storage rates by inflating the embedded costs of base gas, and, thus, the return and tax component of the WSS-OA rates.

188. If left in place, Fortis and South Jersey argue, the provision will result in higher incremental rates that are not reflective of service enhancements. Even if Transco is able to find replacement storage customers willing to assume all of the capacity of every historic customer who terminates its service and withdraws its share of base gas, the WSS-OA replacement customers' rates would be increased to the then-market price of gas. As such, the WSS-OA replacement customers' average rate would be higher than today's rolled-in rate, even though Transco had provided no service enhancements, they contend.

189. Fortis and South Jersey state that likewise, Section 8.2-driven "rate inflation" will occur even when Transco is unable to find a replacement customer willing to take all of the terminating WSS-OA customer's capacity, because Transco will file to increase the rates of all remaining WSS-OA customers in order to cover the costs of the base gas Transco had to acquire to maintain total system deliverability in the absence of a replacement customer.

190. Fortis and South Jersey argue that, furthermore, the Section 8.2 base gas purchase provision is unjust and unreasonable because it 1) is inconsistent with Commission

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[235] Exh. FS-18.

storage policies and universal pipeline storage practices, 2) is without any peer among the universe of NGA regulated pipelines, 3) cedes basic control of base gas and base gas pricing to the unfettered, unilateral discretion of WSS-OA customers to make base gas purchases, and 4) eliminates the traditional gain-sharing between the pipeline and its customers with regard to subsequent base gas sales, thus reducing Transco's incentive to operate its storage field efficiently and with minimal base gas losses.[236] Moreover, Fortis and South Jersey assert, the base gas purchase provision forces Transco into the business of selling, purchasing, and replenishing massive quantities of base gas, thus exposing Transco to significant operational and market risks, and subjecting it to marketing and other administrative expenses.

191. Fortis and South Jersey claim that the purchase option creates a perverse incentive for WSS-OA customers to exercise their base gas purchase rights during gas price spikes, when replacement gas and/or transportation capacity is likely to be constrained.[237] Fortis and South Jersey argue that the fact that these customers may withdraw this base gas without restriction or cost consequence, while imposing external cost burdens on the remaining storage customers, cannot be reconciled with the Commission's economic efficiency policies. Fortis and South Jersey's witness Jones explains that the base gas purchase provision ensures that Transco's future WSS-OA rate structure will consist of as many as 25 different sets of storage rates, each one specific to a single customer. Consequently, the provision will result in the imposition of additional costs and burdens upon the Commission associated with monitoring and enforcing the Commission's capacity-release and non-discriminatory pricing policies across up to 25 different vintages of capacity, as well as additional costs and burdens upon Transco associated with accounting for and administering these multiple rates.[238]

192. Fortis and South Jersey emphasize that these concerns are not speculative. They note that Exhibit FS-18 shows that primary contract terms of 17 of the 28 WSS-OA customers with base gas purchase rights have already expired. These customers account for nearly 76 percent of the total base gas eligible for purchase under Section 8.2. Accordingly, the majority of WSS-OA customers with base gas purchase rights not only have the incentive to "cash in," but the contractual means to do so. Additionally, every such customer has the right to permanently release its capacity and exercise its purchase option at any time. Fortis and South Jersey argue that this is an untenably volatile state of affairs that will worsen as the remainder of the base-gas eligible contracts expire.

193. Furthermore, Fortis and South Jersey claim that the fact that the purchase rights

[236] Exh. FS-1 (Jones Test. 16:9-17:17, 18:19-19:13).

[237] Exh. FS-1 (Jones Test. 36:9-37:17).

[238] *Id.* at 37:18-22.

were the product of a settlement does not confer upon them any special legitimacy. Fortis and South Jersey contend that the legitimacy of the base gas purchase rights must be evaluated on the basis of their justness and reasonableness under current conditions, and that no higher "public interest" showing is required of them.

194. Fortis and South Jersey add that circumstances have changed over the past 30 years. The Storage Settlement dates from a time when pipeline bundled sales service was the only service available, and then only in those instances where the pipelines had sufficient gas supply. In contrast, Fortis and South Jersey explain, today's gas markets are characterized by flexible access to numerous sources of supply, stand-alone storage and transportation service options, and mostly vigorous competition among numerous wholesale suppliers of natural gas. And because gas commodity prices are largely deregulated, supply-driven curtailments are nearly non-existent. Fortis and South Jersey claim that the continued existence of these unfettered base gas purchase rights is an anomaly and that no other pipeline has them.

195. According to Fortis and South Jersey, the likelihood that the base gas purchase provision will produce adverse effects is high. As an example, Fortis and South Jersey note that two WSS-OA customers who exercised their purchase rights drove the massive storage rate increase proposed in this proceeding. Fortis and South Jersey stipulate that many more WSS-OA customers are poised to do the same, as 17 of 28 WSS-OA customers, representing some 76 percent of the total base gas eligible for purchase under Section 8.2, are taking service under contracts whose primary terms have expired. Accordingly, Fortis and South Jersey claim, the overwhelming majority of WSS-OA customers with base gas purchase rights not only have the incentive to "cash in," but the direct contractual means to do so.

c) WSS Customer Group

196. The WSS Customer Group argues that Fortis and South Jersey have failed to demonstrate that the existing base gas repurchase provisions contained in Transco's WSS tariffs are unjust and unreasonable. The WSS Customer Group says that Transco witness Hutson refuted the testimony of Fortis and South Jersey witness Jones as speculative and without historical precedent.[239] The WSS Customer Group contends that most WSS shippers are local distribution companies that utilize WSS service to serve their end use customers and are not in the business of looking for price arbitrage opportunities in the interstate capacity markets. As such, the WSS Customer Group explains, these entities have little incentive to "cash out" their investment in WSS service, even when prices spike in the commodity market, because to do so they would need to relinquish their

[239] Exh. T-3 (Hutson Test. 6-7).

underlying WSS capacity rights. The WSS Customer Group asserts that there is no historical evidence that Transco has ever had difficulty finding gas on the commodity markets when needed to support service or that Transco is unable to manage incremental rate structures.

197. WSS Customer Group also claims that the WSS repurchase rights challenged by Fortis and South Jersey were approved in 1975 by the Commission's predecessor, the Federal Power Commission, as part of a comprehensive settlement approving the construction and operation of the Washington Storage Field and establishing WSS service, that these provisions have been in place for more than thirty years without challenge, and that they have been approved in repeated Commission orders revising Transco's WSS tariff sheets. The WSS Customer Group notes that the base gas repurchase rights contained in Transco's tariff did not become an issue until this proceeding. The WSS Customer Group argues that Fortis and South Jersey now seek to mitigate the cost consequences of the transactions they entered into by having historic customers subsidize replacement shippers through elimination of the base gas repurchase right.

198. Additionally, the WSS Customer Group explains, the initial implementation of these rights was the result of a settlement to which all parties agreed. While Fortis at least was not a party to that settlement, it has succeeded to the capacity rights of a party that was part of that settlement. The WSS Customer Group argues that new customers like Fortis and South Jersey, who subscribe to WSS service and are capable of knowing about and protecting themselves from the requirement to pay the costs of replenishment base gas by negotiating with their releasing shippers, have no right to expect that service will be provided to them at less than incremental cost when their releasing shippers exercise repurchase rights. The WSS Customer Group underscores that the Commission has expressed strong support for preserving the sanctity of settlement agreements.[240]

199. The WSS Customer Group agrees with Transco and the NYPSC that Fortis and South Jersey's NGA Section 5 proposal to eliminate or modify the base gas repurchase rights of historic customers was not reserved for resolution in this proceeding. The WSS

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[240] *See Brooklyn Union Gas Co. v. FERC*, 409 F.3d 404, 407 (D.C. Cir. 2005) (affirming FERC's conclusion that "a strong commitment to preexisting settlements would better serve the public interest than allowing modifications over the objection of one or more parties."). *See also Mobil Oil Corp. v. FPC.*, 570 F.2d 1021, 1026 (D.C. Cir. 1978) (providing that it is in the public interest to abide by settlements which are entered into in good faith); *Sunoco, Inc. (RM) Transcontinental Gas Pipe Line Corp.*, 111 FERC ¶ 61,400 (2005) (finding a Commission order to be in the public interest because it enforces the sanctity of a jurisdictional settlement agreement).

Customer Group notes that only a single issue was reserved for hearing in Section VII.A of the settlement -- Transco's Section 4 proposal to charge Fortis and South Jersey incremental rates to recover Transco's costs of purchasing replenishment base gas. The WSS Customer Group asserts that a resolution of Fortis and South Jersey's Section 5 proposals in this proceeding on their merits would suggest that issues reserved in a settlement agreement for subsequent disposition through hearing are neither binding nor limiting on the parties to the settlement who agreed to them. This result could create a disincentive to settlements before the Commission because of the lack of certainty it engenders with respect to what issues may be raised by settling parties under Section 5 of the NGA after a settlement is approved by the Commission.

d) New York Public Service Commission

200. The NYPSC argues that the issue of whether the base gas purchase option that Transco's tariff affords to certain WSS-OA customers is just and reasonable is outside the scope of this hearing. The NYPSC notes that the Settlement, in Article VII.A, defined the scope of the reserved issue as:

> The parties have agreed to reserve for resolution pursuant to hearing or further settlement the issue of Transco's proposal under NGA Section 4 to establish incremental rates under Rate Schedule WSS-Open Access to Cinergy Marketing & Trading, LP (and its successor Fortis Energy Marketing & Trading) and South Jersey Resources Group, LLC to recover Transco's cost of purchasing replenishment base gas.

201. The NYPSC contends that the settlement language is unambiguous and does not allow for litigation of the base gas purchase option. The NYPSC notes that, as a term in a FERC-approved settlement, the Commission is obligated to give effect to Article VII.A as agreed to by the participants.[241] If a FERC-approved settlement agreement unambiguously addresses a matter at issue, the Commission must give effect to the unambiguously expressed intent of the parties.[242] The test for whether a contract is ambiguous is "whether the language at issue 'is reasonably susceptible of different constructions or interpretations.'"[243] A contract "is not ambiguous simply because the

[241] *See, e.g.*, *Dominion Transmission, Inc. v. FERC*, 533 F.3d 845 (D.C. Cir. 2008); *Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 235 (D.C. Cir. 1986); *Continental Oil Co. v. FPC*, 373 F.2d 96, 100 (10th Cir. 1967); *Texas Eastern Transmission Corp. v. FPC*, 306 F.2d 345, 348 (5th Cir. 1962).

[242] *See Ameren Services Co. v. FERC*, 330 F.3d 494, 498 (D.C. Cir. 2003).

[243] *El Paso Elec. Co. v. Tucson Elec. Power Co.*, 115 FERC ¶ 61,101 at P 32 (2006) (quoting *Ameren*, *supra*).

parties disagree as to its interpretation."[244]

202. The NYPSC explains that Section VII.A provides that the issue reserved for this proceeding concerns the justness and reasonableness of Transco's incremental rate proposal made under Section 4 of the NGA to recover specific costs associated with particular storage base gas purchases. This issue regards the cost of purchasing replenishment base gas associated with the WSS base gas that Transco bought to replace the gas taken by the releasing shippers, PSEG and South Jersey Gas.

203. The NYPSC underscores that Transco's incremental rate proposal under NGA Section 4 does not encompass the elimination and/or modification of the existing base gas purchase option included in Section 8.2 of Rate Schedule WSS-OA. The NYPSC also points out that Transco did not propose a change to the base gas purchase option in its NGA Section 4 incremental rate proposal. The NYPSC emphasizes that Fortis and South Jersey's proposal to eliminate the right to make future base gas purchases is not related to the allocation of the cost of specific base gas purchases that have already been made. Also, Fortis and South Jersey do not dispute that they are seeking to eliminate the base gas purchase option under Section 5 of the NGA.

204. Furthermore, the NYPSC argues, Article VII.A cannot reasonably be interpreted to encompass the base gas purchase option issue. Assuming that Article VII.A could be characterized as ambiguous regarding the scope of the issue reserved for hearing, the Presiding Judge and the Commission may look to the Settlement as a whole, as well as extrinsic evidence of the parties' intent, to prove a meaning to which the settlement language is reasonably susceptible.[245] The NYPSC explains that considering the Settlement as a whole supports the conclusion that the reservation in Article VII.A was not intended to encompass proposals to eliminate or modify the base gas purchase option. For instance, Article V.B of the Settlement provided for a modification to Section 8.3 of Rate Schedule WSS-Open Access to give Transco the right to submit future limited NGA Section 4 filings proposing to recover from WSS-OA replacement shippers "any increase in the cost of service attributable to Transco's replenishment of base gas to serve the new Buyers contracting for capacity vacated, through termination or permanent capacity release, by a terminating Buyer."[246] Providing Transco the option to make Section 4 rate filings associated with "replenishment of base gas" necessarily presupposes that the WSS-OA purchase option would continue in force and that there could be a need for such base gas replenishment. The NYPSC argues that the absence of any specific language in

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[244] *Duquesne Light Co.*, 122 FERC ¶ 61,039 at P 85 (2008) (citing *Appalachian Power Co. v. FPC*, 529 F.2d 342, 347-48 (D.C. Cir. 1976)) (rehearing pending).

[245] *See, e.g., Duquesne Light Co.*, 122 FERC ¶ 61,039 at P 85.

[246] *Transco Stipulation and Agreement*, *supra*, Art. V. B.

Article V.B suggesting that the purchase option was at issue supports a conclusion that the parties did not contemplate further litigation of it.

205. The NYPSC notes that the question of whether incremental pricing is appropriate for Fortis and South Jersey is of a different character than the question of whether the WSS base gas purchase option should be eliminated or modified. Whether incremental rates are appropriate is a cost allocation question. The NYPSC contends that it strains credulity to think that, by reserving the right to litigate the issue of Transco's Section 4 incremental rate proposal, the parties also thereby intended to reserve the question of whether the long-standing gas purchase option rights of WSS-OA shippers should be eliminated or modified. The NYPSC underscores that if the participants in this proceeding had also intended to reserve for hearing the important base gas purchase option rights, they would have done so explicitly. The NYPSC provides that it did not think that Article VII.A intended to reserve the base gas purchase option for hearing.

206. The NYPSC contends that extrinsic material in the record also supports a finding that Article VII.A was not intended to reserve the WSS base gas purchase option for hearing. The NYPSC notes that, at the January 30, 2008 prehearing conference in this case – prior to the submission of Jones' testimony – I stated my understanding of the issue to be:

> "whether the incremental rates to recover Transco's cost of purchasing replenishment base gas as set forth in Transco Rate Schedule WSS-Open Access that are applicable to Fortis Energy Marketing and Trading, LP, and South Jersey Resources Group, LLC, are just and reasonable and not unduly discriminatory or preferential under Section 4 of the Natural Gas Act. [247]

Counsel for Fortis at the prehearing conference generally agreed with this formulation of the scope of the case, indicating only that Fortis might have an "alternative proposal" that would be within "the general inquiry" raised by Transco's filing.[248] Counsel for Fortis did not mention a NGA Section 5 proposal to eliminate or modify the base gas purchase option.

207. The NYPSC also notes that the Joint Statement of Issues identifies the base gas purchase issue as a Section 5 issue separate from the justness and reasonableness of Transco's incremental rate proposal. The NYPSC argues that Fortis and South Jersey's acknowledgement that their proposal to eliminate or modify the purchase option is a distinct NGA Section 5 proposal was a concession that their proposal is outside the scope

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[247] Pre-hearing Conference Tr. at 97-98.

[248] *See* Pre-hearing Conference Tr. 98.

of the reserved issue. In defending against the motions to strike Jones' testimony, Fortis and South Jersey also suggested that their proposal to eliminate or modify the base gas purchase option could be addressed because it was not "expressly precluded by the terms of the [Settlement]."[249] But under the contract interpretation principle of *expressio unius est exclusio alterius*, the NYPSC contends, the fact that the participants specifically reserved one narrow issue for hearing implies that they intended to preclude further litigation on other issues.[250] This was the NYPSC's understanding of the Settlement. The NYPSC argues that accepting Fortis and South Jersey's argument could interfere with the negotiation of settlements in FERC cases by requiring participants to formulate exhaustive lists of the issues that are precluded from further litigation rather than allowing parties to rely on general provisions regarding the scope of settlements. In conclusion, the NYPSC underscores that the Settlement states that Commission approval would constitute "the final disposition of all outstanding issues in Docket Nos. RP06-569-000 and RP07-376-000 except as to (a) the reserved issue pursuant to Section A of Article VII . . . ."[251]

208. The NYPSC also argues that, if the base gas purchase option is not reserved by settlement, it may only be adjudicated in this case if necessary to avoid serious harm to the public interest. Fortis and South Jersey have suggested that, even if the base gas purchase option were deemed to be outside the scope of the reserved issue under Article VII.A, the Presiding Judge and the Commission should nonetheless address it in this proceeding.[252] The NYPSC explains that expansion of the hearing in this manner would represent a modification to the Settlement which, under Article X.G of the Settlement, would require Fortis and South Jersey to meet the *Mobile-Sierra* public interest standard.[253] To satisfy that standard, Fortis and South Jersey would need to show that precluding litigation of the base gas purchase option issue in this docket would "seriously

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[249] Fortis and South Jersey Answer to Motions to Strike at 6.

[250] *See, e.g.*, *Cleveland Elec. Illuminating Co.*, 82 FERC ¶ 61,254 at p. 62,017 n.9 (1998).

[251] *Transco Stipulation and Agreement*, *supra*, Art. XI.

[252] *See* Fortis and South Jersey Answer to Motions to Strike at 7-8.

[253] *See Dominion Transmission*, 583 F.3d 845; *see also Transco Stipulation and Agreement*, *supra*, Art. X. G (providing that "[a]fter this Agreement becomes effective as provided in Article XI, the standard of review applicable to be applied by the Commission in considering any change to any then-effective provision of this Agreement shall be the 'public interest' standard set forth in *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956)").

harm the public interest."[254] The NYPSC asserts that Fortis and South Jersey have not attempted to make such a public interest showing and that it was difficult to imagine how they could do so given that their justification for litigating the base gas purchase option is to address speculative harm arising from base gas purchases which may or may not ever take place.

e) Commission Trial Staff

209. The Staff does not address this issue.

2. Discussion

a) Burden of Proof

210. In determining pursuant to Section 5 of the Natural Gas Act whether Transco's base gas purchase option under Section 8.2 of Transco's Rate Schedule WSS-OA is unjust and unreasonable, the Commission assigns the burden of proof to its challengers, Fortis and South Jersey.[255]

b) Scope of the Hearing

211. Addressing this issue requires consideration of several preliminaries. Before the justness and reasonableness of Transco's base gas purchase option under Section 8.2 of Rate Schedule WSS-OA is determined, it must first be decided whether this issue can be heard at all in this proceeding. The parties defined the scope of the reserved issue in this proceeding in their Settlement Agreement as follows:

> The parties have agreed to reserve for resolution pursuant to hearing or further settlement the issue of Transco's proposal under NGA section 4 to establish incremental rates under Rate Schedule WSS-Open Access to Cinergy Marketing & Trading, LP (and its successor Fortis Energy Marketing & Trading) and South Jersey Resources Group, LLC to recover Transco's cost of purchasing replenishment base gas.[256]

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[254] *Dominion Transmission*, 583 F.3d 845 (quoting *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733, 2736 (2008)).

[255] *Norstar Operating, LLC v. Columbia Gas Transmission Corp.*, 122 FERC ¶61,163, at 61,840 (2008).

[256] *Settlement Agreement*, Art. VII.A.

212. Transco,[257] WSS Customer Group,[258] and NYPSC[259] argue that the Settlement Agreement reserved a single issue for hearing and that this precludes consideration of other issues. NYPSC asserts in this regard that the Commission is obligated to give effect to the provisions of FERC-approved settlement agreements[260] and to the parties' unambiguously expressed intent in such provisions.[261] According to NYPSC, such a contract is ambiguous only if it is "reasonably susceptible" to different interpretations and "not simply if parties later disagree on its meaning." [262]

213. This statement is true so far as it goes, but fails to take into account that in assessing the plain meaning of any contract, it must be construed "as a whole," giving effect to all of the contract's terms.[263] So with the Settlement Agreement, all of its parts, not just Article VII, must be considered as a whole to determine whether the parties intended to preclude other issues from consideration in this proceeding. [264]

214. Other provisions of the Settlement Agreement besides the reservation clause in Article VII make unambiguously clear that other issues may be addressed in this proceeding. Section X of the Settlement Agreement, entitled "Reservations," states, in particular, as follows:

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[257] Transco Initial Brief at 21-22.

[258] WSS Customer Group Reply Brief at 5.

[259] NYPSC Initial Brief at 5.

[260] NYPSC Initial Brief at 4 (*citing Dominion Transmission, Inc. v. FERC*, 533 F.3d 845 (D.C. Cir. 2008); *Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 235 (D.C. Cir. 1986); *Continental Oil Co. v. FPC*, 373 F.2d 96, 100 (10th Cir. 1967); *Texas Eastern Transmission Corp. v. FPC*, 306 F.2d 345, 348 (5th Cir. 1962).

[261] NYPSC Initial Brief at 4-5 (*citing Ameren Services Co. v. FERC*, 330 F.3d 494, 498 (D.C. Cir. 2003).

[262] NYPSC Initial Brief at 4-5 (*citing Ameren Service Company v. FERC*, 330 F.3d 494, 499 (D.C. Cir. 2003) (*Ameren*) (*citing Consol. Gas Transmission Corp. v. FERC*, 771 F.2d 1536, 1544 (D.C. Cir. 1985) and *Bennet Enters., Inc. v. Domino's Pizza, Inc.*, 45 F.3d 493, 497 (D.C. Cir.), *cert. denied*, 516 U.S. 863 (1995)).

[263] *Ameren* at 499 (*citing WMATA v. Mergentime Corp.*, 626 F.2d 959, 961 (D.C. Cir. 1980)).

[264] *Southern California Edison*, 115 FERC 61,100, 61,373, n8 (2006) (*citing Cleveland Elec. Illuminating Co., supra* (saying that "the Commission has an obligation under the FPA to enforce the provisions of parties' contracts.")

> Neither Transco, the Commission, its Staff, nor any other party or person shall be prejudiced or bound hereby in any proceeding except as specifically provided herein. Neither Transco, the Commission, its Staff, nor any other party or person shall be deemed to have approved, accepted, agreed or consented to any concept, theory or principle underlying or supposed to underlie any of the matters provided for herein.[265]
>
> * * *
>
> . . . [E]xcept as expressly provided by this Agreement, the other parties hereto [other than Transco] preserve their rights under the NGA.[266]
>
> * * *
>
> Except as otherwise provided by this Agreement, nothing herein is intended to limit, supersede, or otherwise affect the resolution of issues not expressly resolved hereby. [267]

Thus, even though the issue of the justness and reasonableness of the base gas purchase option in Section 8.2 of Transco's Rate Schedule WSS-OA was not expressly reserved for litigation in Article VII, the parties in Article X explicitly asserted their right to have the Commission resolve it.

215. The NYPSC cites the absence of express language in the Settlement Agreement reserving the purchase option itself as an issue for litigation.[268] NYPSC alludes to the legal doctrine of *expresio unius est exclusio alterius* as support, which provides that when specific matters are mentioned in a contract, matters that are not mentioned are excluded.[269] But this is not the case here; Article X mentions the very things that the NYPSC says Article VII does not cover.

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[265] *Settlement Agreement*, Art. X, Section B.

[266] *Settlement Agreement*, Art. X, Section D.

[267] *Settlement Agreement*, Art. X, Section F.

[268] NYPSC Initial Brief at 7.

[269] *Id.* at 9 (*citing Cleveland Elec. Illuminating Co., supra* (noting the doctrine of *expresio unius est exclusio alterius* and finding that there was no implied condition in a transmission agreement providing that if the City of Cleveland requested transmission the transaction would be a wholesale sale, where the transmission agreement had explicitly included two other conditions)).

216. The Commission has consistently held that presiding administrative law judges in hearings regarding proposed rates may incorporate issues that they find are related to the justness and reasonableness of the rates. For instance, in *Cincinnati Gas and Electric Company* (*Cincinnati Gas*), the Commission concluded that a presiding administrative law judge could consider the prudence of a utility's investment in a generating station where the issue explicitly set for hearing was the justness and reasonableness of the utility's proposed rate increases.[270] The Commission explained that the scope of a hearing is not confined to issues explicitly set for hearing addressing proposed rates, and may encompass issues related to the justness and reasonableness of those rates.[271] The Commission in *Cincinnati Gas* concluded that the recovery of costs associated with the generating station related to the proposed rate increase in that case, adding that the parties had been on notice that intervenors intended to address the prudence of the costs of the generating station.[272]

217. In the same vein, in *Long Island Lighting Company (Long Island Lighting)*, the Commission found that a party could raise issues related to the terms and conditions of a Power Supply Agreement (PSA) even where the Commission did not explicitly state that such factors would be at issue in the order setting the hearing regarding the PSA.[273] Further, in *Connecticut Yankee Atomic Power Company (Connecticut Yankee)*, the Commission established a hearing regarding the justness and reasonableness of proposed rates filed under section 205 of the FPA and included for investigation the justness and reasonableness of a utility's rate of return on common equity. [274] The Commission noted that a hearing regarding the justness and reasonableness of proposed rates includes issues that impact that determination:

> "when the Commission sets for hearing the justness and reasonableness of proposed rates filed under section 205 of the FPA, it necessarily sets for

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[270] *Cincinnati Gas and Electric Company* , 59 FERC ¶ 61,072, at P61,292 (1992).

[271] *Id.* (stating that "the scope of a Commission-ordered evidentiary hearing is not necessarily confined to those issues discussed in detail and 'explicitly' set for hearing. When the Commission sets for hearing the justness and reasonableness of proposed rates, it necessarily sets for hearing all issues that are relevant to an assessment of justness and reasonableness.").

[272] *Id*.

[273] *Long Island Lighting Company*, 83 FERC ¶ 61,076 at P61,378 (1998) (*citing Cincinnati Gas*).

[274] *Connecticut Yankee Atomic Power Company*, 61 FERC ¶ 61,346 at P62,351 and n.11 (1992).

> investigation, and permits the presiding judge to consider, all components of the rate . . . that have some bearing on that determination.[275]

218. Here, the Settlement Agreement has resolved many issues and reserved one for litigation. At the same time, however, it has open-ended wording that relieves its signatories from having "approved, accepted, agreed or consented to any concept, theory or principle underlying or supposed to underlie any of the matters provided for" therein; and that "preserve[s] their rights under the NGA;" and that does not "limit, supersede, or otherwise affect the resolution of issues not expressly resolved" thereby. It would be grossly restrictive to interpret this Agreement as a whole to preclude an examination of the purchase option itself for justness and reasonableness, along with the justness and reasonableness of how the purchase option is to be paid for. Provided other preliminary considerations are met (as discussed further below), a modification of the purchase option would have a direct impact on future cost allocations under the Section 4 tariff proposal in question, and therefore has a direct effect on the justness and reasonableness of that proposal.

219. Although the NYPSC suggests otherwise, the preliminary record developed in this case does not lead to a different result. As I stated in a pre-hearing conference in this case six months prior to the hearing itself, the issue for litigation "as I underst[oo]d it" at the time was the issue reserved in Article VII.A. of the Settlement Agreement.[276] Counsel for Fortis and South Jersey expressly stated at that time, however, that those parties "have not fleshed out the contours of our case" at that point, and that they "may, for example, have an alternative proposal to put before the Judge and the Commission."[277] To that, I replied that when a list of issues and positions was eventually prepared in the case, I expected that the parties would "hammer out exactly what the issue is that you want to present to me; so I recognize that this is not cast in stone, that there might be some refinements to it."[278] Hence, the procedural history of this case expressly left the issue open.

220. As Fortis and South Jersey correctly point out, the purchase provision has already had the immediate consequence of increasing Transco's storage rates by inflating the embedded costs of base gas, and, thus, the return and tax component of the WSS-OA rates. If left in place, the provision will over time result in higher rates that are not reflective of service enhancements. Even if Transco ultimately is able to find

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[275] *Id*.

[276] *See* Pre-hearing Conference Tr. 98:1-11.

[277] *Id*. at 98:14-17.

[278] *Id*. at 98:21-99:2.

replacement storage customers willing to assume 100% of the capacity of every historic customer who terminates its service and withdraws its share of base gas, all of the WSS-OA rates would still be raised to the then-market price of gas. As such, the average rate paid by the WSS-OA replacement customers would be far higher than today's rolled-in rate, even though Transco had provided absolutely no service enhancements.[279] This prospect necessitates examining the justness and reasonableness of the purchase provision itself as a determinant of the justness and reasonableness of its allocation.

221. Hearing this issue does not interfere with the negotiation of settlements in FERC cases by requiring participants to formulate exhaustive lists of the issues that are precluded from further litigation. It is the open-ended wording of the provisions of Article X of the Settlement Agreement itself that has left open the possibility of litigating other issues here, negating the applicability of the doctrine of *expresio unius est exclusio alterius* here. Parties negotiating future FERC settlements who wish to avoid this possibility need only say so expressly and avoid such open-ended language.[280]

222. In any event, it would be exalting form over substance, and wasteful of Commission and party resources, to force Fortis and South Jersey to file a separate action and require separate Commission consideration just to bring a Section 5 matter so closely tied to the pending Section 4 issue before it. Accordingly, the Section 5 issue can be resolved here.

223. If this Initial Decision were to conclude that the base gas purchase option is unjust and unreasonable under Section 5 of the NGA, that finding would not moot the earlier conclusion herein that Transco's proposal to charge Fortis and South Jersey incremental rates for the base gas replacement costs that Transco has already incurred is unjust and unreasonable. The earlier conclusion addressed the costs that Transco has already incurred in connection with the purchase option as it now stands in the Tariff. In accordance with the "filed rate" doctrine, the exercise of that provision on the part of PSEG and South Jersey Gas cannot be undone now.[281] The issue under consideration

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[279] *See* Fortis/South Jersey Initial Brief 8-9.

[280] *See L.A. Pipeline Constr. Co. v. Texas Eastern Products Pipeline Co., Div. of Texas Eastern Transmission Corp.*, 699 F. Supp. 185, 188 (S.D. Ind. 1988) ("While the court should be wary of enforcing 'boilerplate' language . . . ., this factor carries little weight where the party is sophisticated and can deal at arm's length.").

[281] *See New York Indep. Sys. Operator, Inc.*, 123 FERC. ¶61,090, P 27 (2008) (Filed rate doctrine "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority. In other words, the doctrine bars the Commission from imposing after-the-fact increases, such as surcharges, on gas already purchased.").

now only concerns the justness and reasonableness of the base gas purchase option going forward.

c) *Mobile-Sierra* Considerations

224. Another preliminary to establish is the appropriate standard of review to apply to this review of an existing tariff provision. The Settlement Agreement provides that the standard of review to be applied by the Commission in considering any change to any of its then-effective provisions is the "public interest" standard set forth in *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).[282] This standard has long been referred to as the "*Mobile-Sierra* doctrine."

225. Under the *Mobile-Sierra* doctrine, the Commission "may abrogate or modify freely negotiated private contracts that set firm rates or establish a specific methodology for setting the rates for service only if required by the public interest."[283] The Commission is required under the doctrine to "presume that the rate set out in a freely negotiated . . . contract meets the 'just and reasonable' requirement imposed by law. The presumption may be overcome only if FERC concludes that the contract seriously harms the public interest."[284]

226. To overcome the presumption of justness and reasonableness, a challenger must show "that the existing rate might impair the financial ability of a public utility to continue its service, or that the rate would cast upon other consumers an excessive burden, or be unduly discriminatory, or that there are other circumstances of unequivocal public necessity."[285] It is in this light that the justness and reasonableness of the base gas purchase option is considered here, bearing fully in mind that the Commission "does not take contract modification lightly" and that an entity "has a heavy burden in demonstrating that the contract ought to be modified," even under the "just and reasonable" standard.[286]

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[282] *Settlement Agreement*, Art. X, Section G.

[283] *Dominion Transmission, Inc. v. FERC*, 533 F.3d 845, 852-53 (D.C. Cir. 2008).

[284] *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733, 2737, 171 L. Ed. 2d 607 (2008).

[285] *Dominion Transmission, Inc. v. FERC*, *supra*.

[286] *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities*

(footnote continued on next page . . .)

d) Justness and Reasonableness of Base Gas Purchase Option

227. Turning at last to the merits, the base gas purchase option now in Section 8.2 of the WSS-OA Tariff was created thirty years ago as part of a settlement approved by the Commission in Docket No. CP74-33, in which Transco applied for a certificate of public convenience and necessity authorizing construction and operation of the Washington Storage Field.[287] The Commission accepted the settlement, with the base gas purchase option, on February 26, 1975, finding that the settlement was "clearly in the public interest."[288] The option first appeared in Section 9.5 of the WSS Rate Schedule effective July 11, 1975.[289]

228. The aggregate amount of base gas now subject to the purchase option under Section 8.2 of the WSS-OA Tariff is approximately 25.9 Bcf.[290] All but three of 31 WSS-OA customers have this purchase right.[291] Also, the primary contract terms of 17 of the 28 WSS-OA customers with base gas purchase rights have already expired, accounting for nearly 76 percent of the total base gas eligible for purchase under Section 8.2.[292] All 17 of these customers, therefore, could potentially exercise their option to purchase base gas now.

229. This purchase option, which has stood for thirty years, resulted from a period of severe gas shortages in the United States. At that time of gas supply curtailment, the original customers of the Washington Storage Field gave up their ability to purchase certain firm sales volumes in order to create the Field, in return for the right to purchase their respective shares of the base gas volumes at historic rates when and if they no longer received WSS service.[293]

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and Transmitting Utilities, Order No. 888, FERC Stats. & Regs. ¶ 31,036, at 31,664-65 (1996).

[287] Exh. T-3 (Hutson Test. 3).

[288] *Transcontinental Gas Pipe Line Corp.*, 53 FPC 628, 629 (1975).

[289] Exh. T-3 (Hutson Test. 4).

[290] Exh. FS-18.

[291] *Id*.

[292] *Id*.

[293] Exh. T-3 (Hutson Test. 3-4).

230. At that time, Transco injected these volumes into the Washington Storage Field as base gas. Transco incurred the gas purchase cost and held title to the gas, and continues to do so.[294] Up to now, three WSS customers have exercised this option by purchasing base gas from Transco at historic average cost. No other storage service offers a similar base gas purchase option.[295]

231. As Transco witness Hutson observed, the Commission recognizes "a strong commitment to preexisting settlements" in that they "better serve the public interest than allowing modifications over the objection of one or more parties."[296] However, according to the precedents that Hutson cited, the Commission does not enforce preexisting settlements blindly. Rather, it exercises "common sense and equity" within its "jurisdiction to enforce the sanctity of jurisdictional contracts and settlements it approves."[297]

232. Here, unlike the aforementioned Commission precedents in each of which a party sought to *violate* a preexisting settlement agreement and the Commission was called upon to enforce that agreement under the "public interest" standard,[298] the parties objecting to Fortis and South Jersey's proposal have called into question PSEG and South Jersey Gas's *lawful exercise* of a provision of a pre-existing settlement agreement, as now embodied in Section 8.2 of the WSS-OA Tariff. Fortis and South Jersey are merely beneficiaries of that exercise. Transco and WSS Customer Group are also seeking to revise the longstanding practice of rolling-in base gas purchase costs that the agreement did not explicitly cover or initiate. This set of facts stands the *Mobile-Sierra* doctrine on its head, in a way.

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[294] Exh. T-3 (Hutson Test. 3).

[295] Exh. FS-1 (Jones Test. 16:10-12).

[296] Exh. T-3 (Hutson Test. 4-5), citing *Sunoco, Inc. v. Transcontinental Gas Pipe Line Corp*., 114 FERC ¶ 61,180, at P42 (2006).

[297] *Sunoco, Inc. (R&M) v. Transcontinental Gas Pipe Line Corp*., 111 FERC ¶ 61,400, at P33 (2005).

[298] *See, e.g.*, *Sunoco, Inc. v. Transcontinental Gas Pipe Line Corp*., *supra* (Commission directs Transco to reimburse Sunoco costs that Sunoco incurred as a result of Transco's violation of a settlement agreement); *also see Brooklyn Union Gas Co. v. FERC*, 409 F.3d 404, 407 (D.C. Cir. 2005) (gas pipeline customers objecting to pipeline merger settle with pipeline to maintain existing rates; FERC disapproves settlement in view of earlier agreement to file a rate case by a certain date; Court upholds FERC on basis "that a strong commitment to preexisting settlements better served the public interest than allowing modifications over the objection of one or more parties").

233. All of the parties, by all of their various suggested alternatives to rolling in replacement base gas costs as Transco always did, tacitly admit that that the original 1975 settlement does not work for them anymore. The Commission, in the exercise of the "common sense and equity" that it uses to "enforce the sanctity of jurisdictional contracts and settlements it approves," does not have to adhere slavishly to a 30-year-old and demonstrably unworkable settlement agreement just because it still exists.

234. According to Fortis and South Jersey's witness Jones, gas price spikes create a natural incentive for customers to exercise their base gas purchase options under Section 8.2 in order to capture the run-up in gas values.[299] When gas supplies are short at such times, Jones further opines, this incentive can work against the ability of existing storage customers to access storage at a time when it is most needed in the marketplace.[300] Fortis and South Jersey point particularly to the danger that the base gas purchase provision increases Transco's storage rates by inflating the embedded costs of base gas by creating a regime of multiple and administratively confusing rates to the detriment of gas consumers that rely upon it.[301]

235. As WSS Customer Group has observed, most Transco WSS-OA customers are local gas distribution companies that rely on storage services to fulfill their utility service obligations, not arbitrageurs in the interstate capacity markets.[302] Their interest in maintaining their WSS-OA storage service and not relinquishing their WSS capacity rights, therefore, probably outweighs their financial incentive to capture, or potentially capture, a one-time profit by exercising this purchase option.[303]

236. Still, the potential profit margin between the cost of base gas under the purchase option of Section 8.2 and the current market price of gas presently stands at around 630 percent.[304] This is, without doubt, an irresistible inducement for customers to exercise their options and cash out these profits as PSEG and South Jersey Gas have done,[305] even

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[299] Exh. FS-1 (Jones Test. 37:6-9).

[300] Exh. FS-1 (Jones Test. 37:9-15).

[301] Exh. FS-15 (Jones Test. 4:2-10).

[302] *See* Exh. T-3 (Hutson Test. 6).

[303] *Id*.

[304] *See* n.227, *supra*.

[305] *See* Exh. T-14 at 1 (Fortis and South Jersey's witness Jones identifies the economic impetus for the PSEG and South Jersey Gas repurchase transactions in a response to a Transco data request by stating that the motivation for PSEG and South

(footnote continued on next page . . .)

those customers that are public utility services with presumably "nobler" intentions. In our current era of turmoil in the financial markets and frozen credit availability, these options are ready sources of cash that option holders may sorely need right now or in the near future.

237. Although the facts of record suggest that the financial impacts of the base gas purchase option are serious enough to warrant a rebuttal of the presumption of justness and reasonableness that the provision enjoys under the *Mobile-Sierra* doctrine,[306] Fortis and South Jersey's contentions are premised on the notion that incremental rates are adopted as to them and the rates of non-incremental customers are left unchanged. They are not premised on the notion that rolled-in rates are adopted as to all customers, as has been done in the first part of this Initial Decision. Having to buy gas at high prices still raises the embedded cost of base gas under rolled-in rates just as they do under incremental rates, but that rising cost is shared equally by all customers under rolled-in rates, not unequally as they are under incremental rates. Rolling-in rates maintains the status quo prior to the start of this litigation, which is what Fortis and South Jersey admit they expected to face when they entered into these transactions.

238. Consequently, even if the *Mobile-Sierra* presumption is deemed to have been rebutted, the evidence of record does not suffice to meet the burden of proof that Fortis and South Jersey bear of showing that preserving the base gas purchase option, *under a rolled-in rate scenario*, is unjust and unreasonable.

239. While the base gas purchase option is not found here to be unjust and unreasonable in light of this Initial Decision's recommended adoption of rolled-in rates rather than incremental rates, it is worth noting in the context of tough financial times like the present that the rate design of the base gas purchase option has built into it a perverse incentive. It encourages customers holding the option to leave the Field and take their shares of base gas with them, with no offsetting contractual commitment that protects the ongoing storage needs of their fellow customers. While the purchase option is a valuable contract right that cannot simply be taken away from customers, as Fortis and South Jersey's suggested alternatives would do, the parties (with the Commission's help) would be well-served to confer and negotiate some reasonable alternative to the option that does

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Jersey Gas's base gas repurchases was to take "economic advantage of the significant difference between the embedded cost of the purchase and the higher market value.").

[306] *See Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1 of Snohomish County*, *supra*, 128 S. Ct. at 2737 (*Mobile-Sierra* presumption "may be overcome only if FERC concludes that the contract seriously harms the public interest.").

not create this potentially destructive inducement.

240. It is useful to note in this regard that if the purchase option did not exist at all, Transco alone would be responsible for the economic decision to leave base gas in the ground or to withdraw it and sell it. That decision would be entirely dependent upon Transco's Commission-approved Tariff obligations, not the vagaries of the money markets that motivate non-jurisdictional WSS customer entities. The very fact that Transco leaves its base gas in the ground to serve the storage needs of its customers and accepts a Commission-imposed return on its base gas investment of 11.75 percent, when it could fetch a profit margin of 630 percent for that same gas in the marketplace, is a testament to the Commission's ability to make parties within its jurisdiction adhere to the public interest in conserving scarce energy resources rather than succumb to wholly profit-driven motives.

e) Conclusion

241. For the foregoing reasons, Fortis and South Jersey have not met their burden of proving that the base gas purchase option of Section 8.2 of the WSS-OA tariff, under a rolled-in rate scenario, is unjust and unreasonable. It is unnecessary, therefore, to consider Fortis and South Jersey's alternatives to it in this Initial Decision.

C. Issue: *In the event that Fortis/South Jersey have carried their burden of proof regarding Issue B above, whether Fortis/South Jersey have demonstrated that their alternative proposal either to eliminate the existing base gas purchase options under Rates Schedule WSS-OA or to make the purchase options exercisable only if Transco has proposed and the Commission has approved a reduction to Transco's WSS-OA capacity is just and reasonable.*

242. In view of the foregoing determination that the base gas purchase option of Section 8.2 of the WSS-OA Tariff is not unjust and unreasonable under a rolled-in rate scenario, the alternatives suggested by Fortis and South Jersey to keeping the option are not considered here.

VI. FINDINGS AND CONCLUSIONS

243. It is found and concluded that Transco's proposal under NGA Section 4 to establish incremental rates under Rate Schedule WSS-OA applicable to Fortis and South Jersey to recover Transco's cost of purchasing replenishment base gas is unjust and

unreasonable and unduly discriminatory and preferential.

244. It is found and concluded to be just and reasonable and not unduly discriminatory or preferential to roll-in the cost of purchasing replenishment base gas to the storage rate of all Rate Schedule WSS-OA customers equally, including Fortis and South Jersey.

245. It is found and concluded that the existing base gas purchase option under Section 8.2 of Transco's Rate Schedule WSS-OA is just and reasonable under the foregoing rolled-in rate.

246. Findings and conclusions stated in the body of this Initial Decision are to be considered incorporated in this list of findings and conclusions. The omission from this Initial Decision of any argument or portion of the record raised by the participants in their briefs does not mean that it has not been considered. All such arguments have been evaluated and found to either lack merit or significance such that their inclusion would only tend to lengthen this Initial Decision without altering its substance or effect.

VII. ORDER

247. IT IS ORDERED, subject to review by the Commission on exceptions or on its own motion, as provided by the Rules of Practice and Procedure, that within thirty (30) days of issuance of the final order of the Commission in this proceeding, Transco shall file revised compliance filings in accordance with the findings and conclusions of this Initial Decision, as adopted or modified by the Commission.

SO ORDERED.

Steven A. Glazer
Presiding Administrative Law Judge

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